BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK
Chairman
JIM IRVIN
Commissioner
TONY WEST
Commissioner

In the matter of

PROPOSED RULEMAKING

A.A.C. R14-6-101 *et seq.* UNDER THE INVESTMENT MANAGEMENT ACT

DOCKET NO. RS-00000A-98-0240

SECURITIES DIVISION'S RESPONSE TO COMMENTS

I.

INTRODUCTION

On April 1, 1999, in Arizona Corporation Commission Decision No. 61613, the Commission ordered that the Securities Division prepare and forward to the office of the secretary of state for publication a notice of proposed rulemaking regarding the repeal of A.A.C. R14-6-101 through R14-6-104 and R14-6-201 through R14-6-209 and the making of A.A.C. R14-6-101 through R14-6-104, R14-6-106, and R14-6-201 through R14-6-212 (collectively the "IM Rules"). The Commission also ordered that a hearing be set by the Hearing Division on this matter on a date no earlier than May 31, 1999. The hearing is set for June 10, 1999, at 10:00 a.m.

The Securities Division files this Response to Comments pursuant to the April 8, 1999, Procedural Order issued by the Hearing Division in connection with Decision No. 61613 (the "Procedural Order"). The Procedural Order requested that responses to written comments received on or before May 20, 1999, be filed on or before May 27, 1999.

The Securities Division received six comment letters (collectively the "formal comment letters") on or before May 20, 1999, from the following: May 19, 1999, letter from the Investment Counsel Association of America, Inc. (the "May ICAA letter"); May 17, 1999, letter from the Certified Financial Planner Board of Standards (the "May CFP letter"); May 12, 1999, letter from

the Institute of Certified Financial Planners (the "May ICFP letter"); and May 7, 1999, letter from Benchmark Financial, Ltd., followed by a May 10 letter forwarding enclosures inadvertently not included in the May 7 letter and a May 18 letter endorsing and attaching a copy of the May ICFP letter (collectively the "May Benchmark letter").

Prior to publication of the notice of proposed rulemaking, to aid in its drafting process, the Securities Division requested and received informal written comments from the industry (collectively the "informal comment letters"), including the following: August 31, 1998, letter from the Investment Counsel Association of America, Inc. (the "August ICAA letter"); the July 17, 1998, letter from the Certified Financial Planner Board of Standards; the July 10, 1998, letter from the Institute of Certified Financial Planners; the July 9, 1998, letter from the Investment Company Institute (the July ICI letter"); and the July 6, 1998, letter from Keats, Connelly and Associates, Inc. The August ICAA letter is attached as an exhibit to the May ICAA letter, which has been docketed in this matter. The remaining informal comment letters are attached to this response as exhibit A.

The Securities Division satisfied many of the concerns raised in the informal comment letters during the drafting process. The comment letters support many of the provisions contained in the IM Rules and the Securities Division appreciates the supporting comments.

After the receipt of the informal written comments, the notice of proposed rulemaking was published and the industry was again given an opportunity to comment. These comments are contained in the formal comment letters, to which the Securities Division now responds.

II

A.A.C. R14-6-106

The adoption of A.A.C. R14-6-106 (rule 106) is supported by the industry. The rule provides that the general dissemination of information on the Internet by investment advisers and investment adviser representatives shall not be deemed transacting business in Arizona based solely on that activity if the conditions contained in the rule are observed. Rule 106 is based on the North

American Securities Administrators Association, Inc. ("NASAA") interpretive order concerning the use of the Internet for general dissemination of information, a copy of which is attached as exhibit B.

The May ICFP letter recommends three changes to rule 106 as proposed by the Securities Division.

1. The ICFP recommends that the Commission include the term "federal covered adviser" in the rule to clarify that rule 106 applies to both state and federally registered investment advisers.

The IM Rules apply to all investment advisers as defined in A.R.S. § 44-3101(2). (A.A.C. R14-6-102.) When appropriate, the IM Rules specifically indicate when a provision is applicable only to investment advisers that are federally registered--defined as "federal covered advisers" in rule 101--or investment advisers that are licensed or required to be licensed under the IM Act. Throughout the Investment Management Act, A.R.S. §§ 44-3101 through 44-3324 (the "IM Act"), and the IM Rules promulgated thereunder, the term "investment adviser" refers to all persons who fall within the statutory definition, whether federally registered or state licensed.

Rule 106(A) begins "Investment advisers and investment adviser representatives who use the Internet . . . ." The Securities Division does not agree that rule 106 does not clearly apply to both federally registered investment advisers and state licensed investment advisers because the use of the terms "investment advisers and investment adviser representatives" is consistent with the use throughout the IM Act and related rules. The Securities Division received no other comments on this provision and recommends making no change.

2. The ICFP recommends that the Commission delete the prohibition from effecting transactions in securities contained in rule 106(A)(1)(b) and 106(A)(4). The ICFP states that, technically speaking, an adviser cannot execute a securities transaction under the IM Act.

The language contained in rule 106(A) prohibits an investment adviser from communicating with persons in Arizona about effecting or attempting to effect transactions in securities. Such a communication is investment advice. Upon consideration, however, the Securities Division does

not believe the deletion of the opposed language changes the impact or application of the rule. The Securities Division proposes that rule 106(A)(1)(b) be revised as follows.

> The investment adviser or investment adviser representative may only communicate with persons in Arizona individually about ~~effecting or attempting to effect transactions in securities,~~ rendering investment advice for compensation~~,~~ or solicit or negotiate ~~soliciting or negotiating~~ for the sale of investment advisory services if first compliant with or exempt from licensure or notice filing requirements.

The Securities Division proposes that rule 106(A)(4) be revised as follows.

> The Internet communication does not involve either ~~effecting or attempting to effect transactions in securities,~~ the rendering of investment advice for compensation~~,~~ or individualized solicitation or negotiations for the sale of investment advisory services in Arizona.

3. The ICFP recommends that the Commission include in subsection (A)(4) the phrase "unless the investment adviser or investment adviser representative is compliant with or exempt from licensure or notice filing requirements" so that investment advisers are not precluded from relying upon the de minimus exemption.

Rule 106 states that an investment adviser is not deemed to be transacting business if it meets the conditions of rule 106. If an investment adviser does not meet the conditions, and is thus transacting business, it is then subject to A.R.S. § 44-3151(A). Section 44-3151(A) states that the person must license unless . . . it is exempt. A.R.S. § 44-3152 provides the de minimus exemption from § 44-3151 licensure requirements. Thus, a person is not precluded from relying on the de minimus exemption by rule 106.

The provision of the NASAA interpretive order upon which Rule 106(A)(4) is based does not include the suggested language. The Securities Division received no other comments on this provision and recommends making no change.

. . .

. . .

III

A.A.C. R14-6-201

A.A.C. R14-6-201 (rule 201) identifies the books and record keeping requirements. The rule imposes the same requirements as those imposed upon federally registered investment advisers by federal rule 204-2, plus three additional books and records provisions.

The May ICAA letter commented that in rule 201(A) the Commission should use the NASAA's model language, which states "[t]hose books and records required to be maintained and preserved in compliance with Rule 204-2 of the Investment Advisers Act of 1940, notwithstanding the fact that the investment adviser is not registered or required to be registered under the Investment Advisers Act of 1940." The ICAA states that the NASAA model language is less ambiguous.

The Securities Division does not agree that the language used in the NASAA model is less ambiguous than that proposed in rule 201. Essentially, the model language states that even though an adviser is not federally registered, or required to be federally registered, that adviser must maintain the books and records required to be in compliance with federal rule 204-2. Technically, because federal rule 204-2 imposes no requirement upon a state-licensed investment adviser, a state-licensed investment adviser is in compliance with federal rule 204-2 without maintaining any records or books.

The Securities Division believes that the proposed text of rule 201(A) is more concise than the NASAA model language. The Securities Division has received no other comments on this provision and recommends making no change.

IV

A.A.C. R14-6-203

A.A.C. R14-6-203 (rule 203) enumerates practices that are dishonest and unethical under A.R.S. § 44-3201(A)(13), which provides that an Arizona investment adviser or investment adviser representative license may be denied, revoked, or suspended if the investment adviser or

investment adviser representative engages in dishonest or unethical practices in the securities industry.

The May ICAA letter indicates that the ICAA does not believe subsection 203(B) is adequate because it does not exclude from the rule's purview investment adviser representatives of federal covered advisers.

Because section 44-3201 provides for the denial, revocation, or suspension of an Arizona license held by an investment adviser or investment adviser representative, rule 203 will only impact such licensed persons. Section 44-3201 does not apply to federal covered advisers, nor does it apply to investment adviser representatives who are not licensed or who are exempt from licensure in Arizona. Rule 203, which elaborates on the term "dishonest or unethical practices" contained in § 44-3201 for which an action under that statute may be taken, will only apply to licensed persons. Therefore, upon consideration, the Securities Division recommends that the proposed subsection (B) be deleted in its entirety and subsection (A) be revised as follows:

> ~~A. Except as otherwise provided in subsection (B), "dishonest"~~Dishonest and unethical practices," with respect to investment advisers and investment adviser representatives subject to ~~under~~ A.R.S. § 44-3201(A)(13), shall include but not be limited to the following:

The Securities Division does not, however, agree with the ICAA that rule 203 should not apply to investment adviser representatives of federal covered advisers. The Securities and Exchange Commission ("SEC") does not register or regulate investment adviser representatives, allocating the regulation of investment adviser representatives to the states in which the representatives do business. Section 203(A)(b)(1)(A) explicitly states that "a State may license, register or otherwise qualify any investment adviser representative who has a place of business located within that State." All investment adviser representatives who are licensed in Arizona are and should be subject to statutory and rule provisions under which those licenses may be denied, suspended, or revoked. Therefore, the Securities Division does not recommend adoption of the ICAA suggested change.

V

A.A.C. R14-6-204

A.A.C. R14-6-204 (rule 204) prescribes examination requirements for individual investment advisers and investment adviser representatives for licensure in Arizona. The rule requires a score of at least 70 percent on the series 65 or series 66 examination and the series 7 or series 2 examination. Individuals holding specified designations are not required to take the series 7 or series 2 examination.

The May ICFP letter, the May Benchmark letter, and the May CFP letter request a waiver from the series 65 examination for persons holding the CFP designation.

NASAA is preparing a new series 65 examination to replace the current series 65 examination. The new series 65 examination has not been finalized and has not been adopted by NASAA. The Securities Division understands that the new examination will include elements of the series 7 examination, from which persons holding the CFP designation are currently excluded. The Securities Division understands that the new examination will also emphasize for the first time competency elements of the advisory business as well as knowledge of securities law. The Securities Division fully intends to review the new series 65 examination and, upon the examination's finalization and adoption by NASAA, amend rule 204 appropriately.

Revision of rule 204 in reliance on the anticipated adoption of a new series 65 is premature and the Securities Division proposes no changes to rule 204 at this time.

VI

A.A.C. R14-6-206, R14-6-207, R14-6-208, and R14-6-209

The May ICAA letter includes a comment that applies to A.A.C. R14-6-206 (rule 206), R14-6-207 (rule 207), R14-6-208 (rule 208), and R14-6-209 (rule 209). The May ICFP letter comments only upon rule 206.

Rules 206 through 209 enumerate activities that constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4), which states it is a fraudulent practice and unlawful to engage

in any transaction, practice, or course of business that operates or would operate as a fraud or deceit. Rule 206 states that it is a fraudulent practice for an investment adviser to take or have custody of any securities or funds of any client unless the investment adviser complies with the provisions of the rule. Rule 207 states that it is a fraudulent practice for any person to provide investment advisory services unless that person determines that services are suitable for the particular client prior to providing investment advisory services. Rule 208 enumerates activities that are fraudulent in connection with advertisements. Rule 209 states that it is fraudulent to fail to make certain disclosures regarding financial and disciplinary information.

The Securities Division will respond first to the May ICFP letter.

ICFP Comment. The ICFP requests that the Commission include a safe harbor in rule 206 that would allow an investment adviser to accept third-party checks and endorsed stock certificates to forward to other persons as a service to its clients without being deemed to have custody of the checks and stock certificates. The ICFP urges the Commission to adopt a provision similar to the safe-harbor provisions contained in the SEC custody rule under the Securities Exchange Act of 1934 and the NASAA model rule for broker-dealers.

Rule 206 is modeled after federal rule 206(4)-2 promulgated under the investment advisers act of 1940. The ICFP has requested that the SEC include such a safe harbor in federal rule 206(4)-2. Attached as exhibit C is a letter from the ICFP addressed to Mr. Robert Plaze, of the SEC, elaborating on the issue. The Securities Division understands that the SEC has taken the matter under advisement.

Regarding this issue, the ICFP has also spoken with the Investment Adviser Section Committee of NASAA, which has also taken the matter under advisement. In its April 7, 1999, letter to the ICFP, attached as exhibit D, the NASAA committee stated that it was "unwilling to advocate changes in the custody definition which are not accepted by the SEC. The issue of uniformity between the requirements for SEC registered investment advisers and state regulated investment advisers is a priority."

The Securities Division is not aware, and understands that the ICFP is not aware, of any situation where interpretations of custody have caused investment advisers problems with regulators. The Securities Division concurs with the NASAA committee that adoption of the proposed safe harbor prior to SEC action on the issue would be premature. The Securities Division does not recommend any changes to rule 206 in response to the May ICFP letter.

ICAA Comment. The ICAA comments[1] that federal covered advisers and their investment adviser representatives should be specifically excluded from the application of rules 206 through 209. For the reasons stated in its response to the ICAA's comment on rule 203, the Securities Division does not agree with respect to investment adviser representatives.

With respect to federal covered advisers, the Securities Division has proposed a provision in each rule that limits the application of the rule to the extent permitted by section 203A of the investment advisers act of 1940. The National Securities Markets Improvement Act of 1996 ("NSMIA") amended the investment advisers act of 1940 to preclude state regulation of federal covered advisers, except that "nothing in [section 203A] shall prohibit the securities commission (or any agency or office performing like functions) of any State from investigating and bringing enforcement actions with respect to fraud or deceit against an investment adviser or person associated with an investment adviser."

The NSMIA amendment has created controversy regarding the extent of state jurisdiction "with respect to fraud or deceit" and whether states may define fraudulent activities in their rules. The ICAA is asking that the Commission draw a bright line regarding Arizona's jurisdiction where the United States legislature has failed to do so. The ICAA requests that rules 206 through 209, which specify behavior as fraudulent, explicitly state that they do not apply to federal covered advisers. The Securities Division's position is that the interpretation of section 203A and the

[1] The ICAA cited several documents in its footnotes, but did not include copies of the cited documents. Attached as exhibit E are copies of two of the cited documents, which the ICAA forwarded to the Securities Division on May 25, 1999.

extent of state jurisdiction under that statute should be left to more appropriate forums—the courts and the federal legislature.

The ICAA argues that because the SEC has limited the applicability of its "prophylactic" rules to investment advisers registered or required to be registered under the federal act, states are required to limit their rules to state licensed advisers. This argument is without support. The SEC may limit the scope of its enforcement activities for any number of reasons. The limitation in the federal rules is not mandated by NSMIA. A bright line between federal and state jurisdiction with respect to fraud and deceit enforcement actions is not drawn by NSMIA. Each regulator's interpretation may be another's quandary. For example, the SEC states in its March 10, 1998, letter to Mr. Perlmutter, commenting upon Colorado's proposed statutes (copy at exhibit E, item 4, page 5), that "the Advisers Act only prohibits state regulation of advisers that are actually registered with the SEC . . . . If an adviser is required to be registered with the SEC, but has not done so, it can be subject to state regulation." And yet the SEC has included within the purview of its rules advisers that the SEC acknowledges are subject to state regulation—i.e. advisers required to be registered but that are not registered under the federal act. Thus, reversing the ICAA's argument, states are not precluded from applying their rules defining fraudulent conduct to investment advisers subject to federal registration regulations.

In the July ICI letter, the ICI recommended the language adopted by the Securities Division[2] as subsections (B) in rules 206 and 207, subsection (D) in rule 208, and subsection (F) in rule 209. The proposed language acknowledges that the Commission has no regulatory authority beyond that allocated under section 203A. Similar language is used by NASAA in its model Unethical Business Practices of Investment Advisers rule, which has been adopted by several states. (See introductory paragraph of model rule and list of adopting states attached as exhibit F and examples of state provisions attached as exhibit G.)

[2] The ICI included the exclusion of investment adviser representatives of federal covered advisers in its proposed language, which the Division did not include for the reasons discussed in connection with rule 203.

To abdicate jurisdiction over federal covered advisers with respect to rules 206 through 209 from which states have not been clearly precluded by NSMIA would be irresponsible.[3] To fail to acknowledge that state regulatory jurisdiction over federal covered advisers has been limited by NSMIA would be unrealistic. The language proposed by the Securities Division, similar to language adopted by NASAA and several states, accommodates both considerations.

The Securities Division does propose simplification of the language contained in subsections (B) in rules 206 and 207, subsection (D) in rule 208, and subsection (F) in rule 209 as follows:

> With respect to federal covered advisers, the provisions of this Section only apply to the extent ~~the practice involves fraud or deceit and only to the extent~~ permitted by Section 203A of the investment advisers act of 1940.

The Securities Division opposes further limitation of the applicability of the rules until the limitations the ICAA argues are contained in section 203A as amended by NSMIA have been recognized, interpreted, and established by judicial or legislative forums.

VII

A.A.C. R14-6-210

A.A.C. R14-6-210 (rule 210) defines investment adviser representative, based on the definition contained in federal rule 203A-3 and the NASAA model language.

The May ICFP letter and the May ICAA letter point out that federal rule 205-3, referenced in federal rule 203A-3, has been amended since the Securities Division drafted rule 210 and the dollar thresholds in rule 210 should be raised to conform to the federal amendment. The Securities Division agrees and proposes that rule 210(A)(B)(1) be revised as follows:

(a) Immediately after entering into the investment advisory contract with the investment adviser has at least $750,000 ~~$500,000~~ under management with the investment adviser, or

[3] Abdication of jurisdiction regarding the rules may in fact result in the inability to bring fraud actions against federal covered advisers engaged in egregious conduct if that conduct is among those enumerated in the rules. The adviser would argue that the specific conduct is in a rule that explicitly states it does not apply to federal covered advisers.

(b) The investment adviser reasonably believes, immediately prior to entering into the advisory contract, has a net worth, together with assets held jointly with a spouse, at the time the contract is entered into of more than $1,500,000 ~~$1,000,000~~.

VIII

A.A.C. R14-6-212

A.A.C. R14-6-212 (rule 212) enumerates the filing requirements for licensure, notice filings, and renewals. The May ICAA letter requests that the filing requirements be listed with greater specificity in either the statute (A.R.S. § 44-3153) or the rule.

The Securities Division agrees with the ICAA's proposal and recommends that rule 212 be revised as follows:

R14-6-212. Application, notice filing, and renewal ~~Filing~~ requirements

A. ~~In addition to the items enumerated in A.R.S. § 44-3153(B), a~~An application for licensure as an investment adviser under A.R.S. § 44-3153(B) shall include the following:

1. An original typewritten Form ADV with all information and exhibits required by the form.

2. An audited balance sheet if the investment adviser will have custody of client funds or if the investment adviser requires the payment of advisory fees six months or more in advance and in excess of $500 for each client. The audited balance sheet shall be based on the investment adviser's fiscal year end, shall be prepared in accordance with generally accepted accounting principles, and shall be audited by an independent certified public accountant. The notes to the balance sheet shall state the principles used to prepare the balance sheet, the basis of included securities, and any other explanation required for clarity.

3. ~~1.~~ A notarized affidavit of any officer, director, partner, member, trustee, or manager of the applicant stating:

   a. That a review of the records of the investment adviser has been conducted.

   b. Whether any investment adviser activity has been conducted with residents of Arizona prior to licensure as an investment adviser.

4.~~2.~~ If the applicant intends to have a branch office in Arizona, the address and name of a contact individual located at such branch.

5. If part II of the Form ADV is not completed, the applicant shall submit a copy of the disclosure brochure the applicant gives or will give to clients.

6. The documents and fees required for each investment adviser representative as described in subsection C.

7. The annual licensure fee required by A.R.S. § 44-3181(A).

B. A notice filing under A.R.S. § 44-3153(D) shall include the following:~~items enumerated in A.R.S. § 44-3153(D).~~

1. A manually signed and notarized Form ADV, part 1, page 1, or a copy of Form ADV, part 1, page 1, and an originally executed consent to service of process.

2. The documents and fees required for each investment adviser representative as described in subsection C.

3. The annual notice filing fee required by A.R.S. § 44-3181(A).

C. An application for an investment adviser representative licensure under A.R.S. § 44-3156 shall include the following:

1. A complete Form U-4.

2. Proof of successful completion of required examinations in accordance with A.A.C. R14-6-204.

3. The annual licensure fee required by A.R.S. § 44-3181(A).

D~~C~~. For purposes of A.R.S. § 44-3158(A), a license of an investment adviser or an investment adviser representative shall be renewed upon receipt of the nonrefundable license fee prescribed in A.R.S. § 44-3181.

E~~D~~. For purposes of A.R.S. § 44-3153(E), a notice filing shall be renewed upon receipt of the nonrefundable license fee prescribed in A.R.S. § 44-3181.

IX

Technical Correction

The Securities Division has identified a technical error in the rules that should be corrected. Rule 106(B) should be revised as follows.

Compliance with this Section relieves the investment adviser or investment adviser representative of licensure or notice filing requirements only. The investment adviser or investment adviser representative isare subject to Article 9 of the IM Act and related regulations.

X

RENOTIFICATION OF PROPOSED RULES

If the proposed rules are modified by the Hearing Officer to reflect any of the changes that are proposed in the May ICAA letter regarding rules 206 through 209, the Division recommends that the affected rules be renoticed in the Arizona Administrative Register, through the filing of a Supplemental Notice. The Division does not recommend renotification if the Hearing Officer modifies the rules as recommend by the Division in this Response.

The test for whether a rule change has to be renoticed is in A.R.S. § 41-1025. That section provides that an agency may not adopt a rule that is substantially different from the rule as originally proposed in either a notice of proposed rulemaking or a supplemental notice. In determining whether a rule is "substantially different," all of the following are to be considered: (1) the extent to which all persons affected by the adopted rule should have understood that the published proposed rule would affect their interests, (2) the extent to which the subject matter of the adopted rule or the issues determined by that rule are different from the subject matter or issues involved in the published proposed rule, and (3) the extent to which the effects of the adopted rule differ from the effects of the published proposed rule if it had been adopted instead.

Since it appears that the ICAA's proposed changes to rules 206 through 209 may be substantially different according to these factors, the Division deems it prudent to renotice the rules if the ICAA's proposed changes are recommended by the Hearing Officer. The Division has discussed this issue with the office of the attorney general and that office concurs with the Division's recommendation.

. . .

. . .

XI.

CONCLUSION

In conclusion, the Securities Division hereby submits its Response to Comments for the consideration of the Hearing Officer.

RESPECTFULLY SUBMITTED this 27th day of May 1999.

By: _____
CHERYL T. FARSON
General Counsel, Securities Division
Arizona Corporation Commission

Original filed this 27th day of May 1999 with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007

Copy delivered this 27th day of May 1999 to:

Marc E. Stern
Hearing Officer
Hearing Division
Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 58007

Copies mailed this 27th day of May 1999 to:

Karen L. Barr, General Counsel
Investment Counsel Association of America, Inc.
1050 17th Street N.W., Suite 725
Washington, DC 20036-5503

Duane R. Thompson
Director of Government Relations
Institute of Certified Financial Planners
3801 E. Florida Avenue, Suite 708
Denver, CO 80210-2544

Michael J. Fischer, CFP
Benchmark Financial, Ltd.
3636 North Central Avenue, Suite 1160
Phoenix, AZ 85012

Leonardo A. Canseco, CFP, CPA
Certified Financial Planner Board of Standards
1235 Jefferson Davis Highway
Crystal Gateway One, Suite 602
Arlington, Virginia 22202

Tamara Cain Reed, Associate Counsel
Investment Company Institute
1401 H Street, NW
Washington, DC 20005-2148

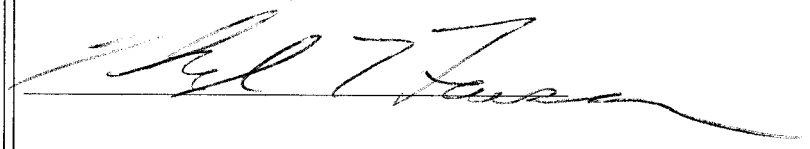


EXHIBIT A

CERTIFIED
FINANCIAL
PLANNER
BOARD OF STANDARDS

[illegible] Highway
[illegible] Suite 602
[illegible] Virginia 22202
[illegible]
[illegible] CFP Board.org
[illegible] rd.org

July 17, 1998

Ms. Cheryl T. Farson
Associate General Counsel
Arizona Corporate Commission
1300 West Washington, Third Floor
Phoenix, Arizona 85007-2996

Re: Proposed amendments to A.A.C. R14-6-101 through R14-6-209; new section R14-6-210

Dear Ms. Farson,

The Certified Financial Planner Board of Standards, Inc. (CFP Board) has no comment on the proposed revisions to the investment adviser rules promulgated in connection with the Arizona Investment Management Act.

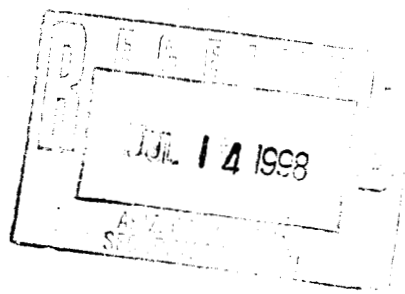
However, we are very pleased to find that under R14-6-204, with respect to the NASD Series 7 or Series 2, Certified Financial Planner (CFP) designees as licensed by the CFP Board continue to remain exempt from such examinations.

To be licensed to meet the CFP Board's certification marks, candidates must meet the experience, ethics, education, and examination standards established by the CFP Board. By promoting standards of high quality, the CFP Board can assure the public that CFP licensees are qualified financial planning professionals. Reliance on the CFP Board marks is important to consumers and CFP designees.

If you have any questions, please contact me at (703) 414-5813.

Sincerely,

Leonardo A. Canseco, CPA, CFP
Washington Director



July 10, 1998

Ms. Cheryl T. Farson
Associate General Counsel
Arizona Corporation Commission
1300 West Washington, Third Floor
Phoenix, Arizona 85007-2996

Re: Proposed amendments to A.A.C. R14-6-101 through R14-6-209; new section R14-6-210.

Dear Ms. Farson:

The Institute of Certified Financial Planners[1] appreciates the opportunity to provide comment on proposed amendments to the Arizona Investment Management Act. Inasmuch as most of the numerous changes are technical in nature, we have only one specific comment on the proposed rulemaking, but several comments on related investment adviser issues.

With respect to solicitation activities clarified in Section R14-6-210, we are supportive of this amendment in further clarifying the definition of "solicitor" so that professional referrals to investment advisers are not deemed to be solicitation activities.

We would note that there is a larger potential issue that may need to be addressed eventually in legislation beyond the scope of this rulemaking. And that is the broad reach of the definition of "investment adviser representative" in Section 44-3101(3)(d), which requires licensing and qualification of solicitors as investment adviser representatives ("IARs"). The state of Arizona currently requires IARs to pass the Series 65 or 66 exams, among others, in order to be licensed. We believe this requirement may become a significant problem for solicitors within a few years, given the proposed changes to the Series 65 exam contemplated by the North American Securities Administrators Association ("NASAA") that would expand the scope of the exam to encompass minimum competency standards for IARs. While we are supportive of competency standards for investment adviser representatives, we believe such an exam may be inappropriate for solicitors who do not provide investment advice to clients of the adviser. In this respect, we believe that "solicitors" should eventually be defined and licensed independently from investment adviser representatives, or exempt from the Series 65/competency exam if their solicitation activities do not include investment advice.

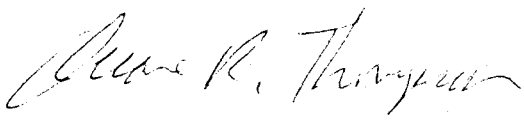
3801 E. Florida Avenue
Suite 708
Denver, Colorado
80210-2544
303.759.4900
Fax 303.759.0749
email icfp@icfp.org
internet http://www.icfp.org

[1] The Institute of Certified Financial Planners is a Denver-based professional association representing approximately 13,000 CFP practitioners nationwide, and 204 in the State of Arizona.

On another issue, we note that the changes to Section R14-6-208 with respect to advertisements are largely technical in nature. However, a related topic of increasing importance is the growing use of web sites as a form of advertisement by investment advisers on the World Wide Web as a form of advertisement. Without clarification in this regard, it is possible that certain Internet communications transmitted into a state may be interpreted by state securities administrators -- or perhaps more problematically for advisers, plaintiff's counsel -- to be "holding out" or "doing business" in the state without appropriate state licensure. We would urge the Commission to consider adoption of a NASAA model interpretive order in connection with web sites and other Internet communications that provides a safe harbor, with certain restrictions, from inadvertently being construed as transacting business in a state if the business location is not located in that state. This model order, entitled "Interpretive Order Concerning Broker-Dealers, Investment Advisers, Broker-Dealer Agents and Investment Adviser Representatives Using the Internet for General Dissemination of Information on Products and Services," can be found in *NASAA Reports*, pages 1286-1288. In the past year, approximately 21 other states have adopted this model order in a uniform fashion.

This concludes our remarks. If you have any additional questions regarding our comments, please do not hesitate to contact the undersigned at 303.759.4900, ext. 129.

Sincerely,



Duane R. Thompson
Director of Government Relations

cc: Arizona societies

Cheryl -

Thanks for sending me the draft rules. Notwithstanding our technical comments, I think they look great. Please let me know if you have any questions about our comments. I hope your summer is going well. Tell Mike, Victor & Leslie I said "hello"!

Tami

9 July 1998

INVESTMENT COMPANY INSTITUTE

July 9, 1998

Cheryl T. Farson
Associate General Counsel
Arizona Corporation Commission
Securities Division
1300 West Washington, Third Floor
Phoenix, Arizona 85007-2996

Re: Proposed Amendments to
Administrative Rules A.A.C.
R14-6-101 through R14-6-209

Dear Cheryl:

The Investment Company Institute[1] appreciates being provided a copy of the amendments that the Division of Securities plans to propose to Rules A.A.C. R14-6-101 through R14-6-209, which relate to the duties of investment advisers and investment adviser representatives.[2] The Institute supports the formal promulgation of the amendments proposed by the Division. We would, however, recommend various additional technical revisions to the proposal.

Each of the revisions recommended by the Institute is intended to ensure consistency between the Division's proposed rules and the provisions of Title III of the National Securities Markets Improvement Act of 1996 ("NSMIA"), which amends the Investment Advisers Act of 1940 ("Advisers Act"). With one exception, which is discussed below, each of our recommended revisions is intended to exclude, where applicable, those investment advisers that are either registered with the U.S. Securities

---

[1] The Investment Company Institute is the national association of the American investment company industry. The Institute also represents the interests of investment advisers. Many of the Institute's investment adviser members render investment advice to both investment companies and other clients. In addition, the Institute's membership includes 499 associate members which render investment management services exclusively to non-investment company clients. A substantial portion of the total assets managed by registered investment advisers are managed by these Institute members and associate members.

[2] The Institute also appreciates being provided a copy of the proposed creation of Rule R14-4-139, which would provide an exemption fro public offerings made to qualified purchasers. Because the provisions of that proposal will not impact the members of the Institute, we will not be commenting upon it.

and Exchange Commission or that are exempt from such registration pursuant to the provisions of Section 202(a)(11) of the Investment Advisers Act of 1940.

In particular, these revisions are necessary to ensure that the Division not run afoul of those provisions in NSMIA that expressly limit the regulatory authority states may assert over federally registered investment advisers.[3] Because the Arizona Investment Management Act defines the term "investment adviser" to include both state-registered and federally-registered investment advisers, it becomes necessary to revise the proposed rules to distinguish those provisions that may lawfully apply to all advisers from those that, pursuant to NSMIA, may only apply to state-licensed advisers.[4] The specific rule revisions that we recommend are detailed in the attachment to this letter. In addition, a copy of the Division's draft that has been redlined to indicate the Institute's recommended revisions is enclosed.

The only revision we recommend that is not based on Section 203A of the Advisers Act is to Rule R14-6-201, which relates to the recordkeeping requirements of investment advisers. In addition to excluding federally registered investment advisers from this proposed rule, we recommend, as noted in the attachment, that it be revised to exclude those out-of-state investment advisers who are registered in their home state and in compliance with such state's recordkeeping requirements. This amendment is necessitated by the amendments in NSMIA to Section 222(b) of the Advisers Act.

We hope you find the enclosed recommendations helpful. If you have any questions concerning them or would like any additional information, please do not hesitate to contact me by phone (202/326-5825) or e-mail (tamara@ici.org).

With regards,

Tamara Cain Reed
Associate Counsel

Attachments

---

[3] Aside from preserving the ability of states to impose notice filing requirements, NSMIA limits state regulatory authority over federally registered advisers to "investigating and bringing enforcement actions with respect to fraud or deceit." (*See* Section 203A(b)(2) of the Advisers Act.)

[4] You will note that, consistent with Section 44-3101(7), in our recommended revisions we utilize the term "licensed investment adviser" to denote those persons that are licensed under Chapter 13 of the Arizona Act.

Recommended Revisions to Proposed Amendments to Arizona Rules Relating to the Duties of Investment Advisers and Investment Adviser Representatives (A.A.C. Rules R14-6-101 through R14-6-209)

July 9, 1998

I. Rule R14-6-201, Books and Records of Investment Advisers

- On page 7: revise the proposed title as follows:

  Books and records of <u>licensed</u> investment advisers

- On pages 7, 10, 14 and 15: revise Subsections A and F and create a new Subsection I as follows:

  A. <u>Except as otherwise provided in subsection I, each licensed</u> ~~Each~~ investment adviser shall . . .

  (*No change to the remainder of Subsection A, including Paragraphs 1-12*)

  13. Notwithstanding the provisions of subsection (12) above, where the investment adviser is primarily engaged in a business or businesses other than advising ~~registered investment companies or other~~[1] advisory clients, a record must be maintained . . .

  (*No change to the remainder of Paragraph 13, to Paragraphs 14-19 of Subsection A, or to Subsections B-E*)[2]

  F. The <u>licensed</u> investment adviser shall maintain . . .

  (*No change to the remainder of Subsection F or to Subsections G and H*)

  <u>I. The provisions of this section shall not apply to any investment adviser that maintains a principal place of business in a state other than Arizona provided that such investment adviser is registered or licensed in the state where it maintains its principal place of business and in compliance with such state's recordkeeping requirements, if any.</u>

---

[1] As with all the other amendments recommended by the Institute, this deletion is purely technical. Pursuant to NSMIA, all investment advisers to registered investment companies would be federally registered and not state registered. To avoid the confusion that would be caused by including in this rule a reference that would be inapplicable to a state licensed investment adviser, we recommend that such reference be deleted.

[2] The Institute notes, however, that there is a typographical error on page 13 in Subsection B, Paragraph 4 where "has" is spelled "ahs."

II. Rule R14-6-202, Supervision

- On page 15, revise the introductory language as follows:

  For purposes of A.R.S. § 44-3201(A)(12), no licensed investment adviser shall . . .

  (*No change to the remainder of the rule*)

III. Rule R14-6-203, Dishonest and unethical practices

- On page 16, revise the introductory language as follows:

  A. Except as otherwise provided in subsection B, "dishonest ~~"Dishonest~~ and unethical practices" with respect to investment advisers and investment adviser representatives . . .

  (*No change to the remainder of the proposed text*)

- On page 19, create a Subsection B to the rule as follows:

  B. With respect to an investment adviser that is registered under the Investment Advisers Act of 1940 and the representatives of such investment adviser, the provisions of this section shall only apply to the extent the practice involves fraud or deceit and only to the extent permitted by the National Securities Markets Improvement Act of 1996.[3]

IV. Rule R14-6-205, Information to be furnished to clients ("Brochure Rule")

- On page 20, revise Subsection A as follows:

  A. Each licensed investment adviser shall furnish each client . . .

  (*No change to the remainder of Subsection A or to Subsection B*)

---

[3] The Institute recommends the use of this language in lieu of merely excluding "licensed investment advisers" to preserve the Division's authority over those persons that are not licensed with the Division or registered under federal law.

- On page 21, revise Subsection C as follows:

  C. ~~An~~ licensed investment adviser need not deliver the statement required by subsection (A) in connection with entering into ~~an investment company contract or~~[4] a contract for impersonal . . .

  (*No change to the remainder of Subsection C*)

- On page 21, revise Subsection D as follows:

  D. Without charge and to each of its clients, a~~n~~ licensed investment adviser annually shall deliver . . .

  (*No change to the remainder of Subsection D*)

- On page 21, revise Subsection E as follows:

  E. If a~~n~~ licensed investment adviser renders substantially . . .

  (*No change to the remainder of Subsection E*)

- On page 22, revise Subsection F as follows:

  F. Nothing in this Section shall relieve any licensed investment adviser from . . .

  (*No change to the remainder of Subsection F*)

- On page 22, revise Subsection G as follows:

  G. ~~An~~ licensed investment adviser that is compensated . . .

  (*No change to the remainder of Subsection G or to Subsections H and I*)

V. Rule R14-6-206, Custody of client funds or securities

- On page 23, revise the introductory language as follows:

  A. Except as provided in subsection B, it ~~It~~ shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser to take or have . . .

  (*No change to the remainder of Subsection A*)

---

[4] *See* footnote 1, above.

- On page 23, create a Subsection B to the rule as follows:

  B. The provisions of this section shall not apply to any person that is registered as an investment adviser under Section 203 of the Investment Advisers Act of 1940 or to any person that is excluded from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940.[5]

VI. Rule R-14-6-207, Suitability of investment advisory services

- On page 24, revise the introductory language as follows:

  A. It shall constitute a fraudulent practice . . .

- On page 24, create a new Subsection B to the rule as follows:

  B. The provisions of this section shall not apply to any person that is registered as an investment adviser under Section 203 of the Investment Advisers Act of 1940 or to any person that is excluded from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940.[6]

VII. Rule R14-6-208, Advertisements

- On page 25, revise Subsection A as follows:

  A. Except as provided in subsection D, it ~~It~~ shall constitute . . .

  (*No change to the remainder of Subsection A*)

- On page 26, revise Subsection B as follows:

  B. Except as provided in Subsection D, when ~~When~~ requested . . .

  (*No change to the remainder of Subsection B or to Subsection C*)

- On page 26, create a new Subsection D as follows:

  D. The provisions of subsections A and B shall not apply to any person that is registered as an investment adviser under Section 203 of the Investment Advisers Act of 1940 or to any person that is excluded from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940.

---

[5] *See* footnote 3, above.

[6] *See* footnote 3, above.

VIII. Rule R14-6-210, Solicitation

- On page 31, revise Subsection C and create a new Subsection D as follows:

C. Except as provided in subsection D, no ~~No~~ individual or entity . . .

(*No change to the remainder of Subsection C*)

D. The provisions of subsection C shall not apply to a person that, at the time of the solicitation, is either registered under Section 203 of the Investment Advisers Act of 1940 or excluded from the definition of investment adviser under Section 202(a)(11) of the Investment Advisers Act of 1940, provided that at the time of the solicitation the person is not the subject of an order under federal law that denies, revokes or suspends his or her ability to conduct an advisory business.[7]

---

[7] Pursuant to NSMIA, states may no longer deny the ability of a federally registered investment adviser or of a person that is exempt pursuant to the provisions of § 202(a)(11) of the Advisers Act to conduct an advisory business or to solicit to conduct an advisory business. Because the provisions of Subsection C of this proposed rule would extend to such persons who, in the past, were subject to an order of denial, revocation, or suspension under federal law, we believe it is necessary to limit the applicability of Subsection C to those instances in which the order is currently in effect.

KEATS, CONNELLY
and Associates, Inc.

CROSS-BORDER
PLANNING AND
INVESTMENT
SPECIALISTS

July 6, 1998

Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

Attn: Cheryl T. Farson

Re: Proposed amendments to A.A.C. R14-6-101 through R14-6-209; new section R14-6-210

Dear Ms. Farson:

Thank you for allowing me the opportunity to make comments on the proposed amendments.

I have enclosed a copy of the proposed amendments with my changes, except as noted below. My general comments are:

- The format of the document was inconsistent and the numbering and lettering system was incorrect in a number of places. Need to be consistent with both the depth of the indention and whether to indent at all. For example: in R14-6-101(B)(1) the number 1 was indented 1¼ inches and "Advertisement" was not indented. Whereas, old number R14-6-101(B)(3) was indented 1½ inches and "Certified..." was indented.
- The numbering system is not correct. Using the above references, you will notice the jump from 1 to 3. I have made the necessary changes on the enclosed document.
- In general, numbers 1-10 should be written out as one, two, etc. Numbers 11 and higher should be left in their numeric form.
- There are numerous run-on sentences. I found sentences as long as 100 words in length. You need to break up those sentences so that we can understand them.
- Need consistent use of semi-colons. See page 12, R14-6-201(A)(17), (18) & (19). These sections use a semi-colon to separate them; numbers 1-16 did not.

PHOENIX • 4645 N. 32nd Street • Suite A-125 • Phoenix, AZ 85018-3308 • PHONE 602/955-5007 • FACSIMILE 602/224-5874
TUCSON • 7400 N. Oracle Road • Suite 100B • Tucson, AZ 85704-6342 • PHONE 520/297-9195 • FACSIMILE 520/742-7402
keatscon@sprynet.com

My substantive comment is that the definition of Certified Public Accountant should be changed to reflect the fact that a CPA can be registered or licensed to practice, but not allowed to use the title "Certified Public Accountant" or the initials CPA after his or her name. This restriction is not due to any sanctions imposed, but rather by statute (Section 32-733). The statute states that a CPA can not hold him or herself out as a CPA if the person is performing accounting functions and is not working for a public accounting firm registered with the state. The Arizona State Board of Accountancy and statute defines accounting very broadly. The practice of public accounting is defined as "provision of any accounting services, including recording and summarizing financial transactions, analyzing and verifying financial information, reporting financial results to an employer, clients or other parties and rendering tax and management advisory services to an employer, clients or other parties." As you can see, this pretty much eliminates a CPA from doing any work for which he or she has been trained, if that person does not work for a public accounting firm.

Since I imagine that CPAs in public accounting will generally use the broad exclusion under this act, the CPAs subject to the "Act" would not be able to hold themselves out as CPA. Your current definition would eliminate those CPAs most likely to fall within the provisions of the "Act" and would therefore, not be effective. The various states' rules on holding out have been fought and lost by the states in every jurisdiction it has been contested. This rule is currently being contested in Arizona.

My suggestion for a definition for CPA is – "Certified Public Accountant" or "CPA" means an accountant who is currently registered or licensed to practice public accounting.

Thank you for the opportunity to review proposed amendments to the Investment Management Act. I hope that my comments were valuable. It you have any questions or need clarification of a comment I made, you can contact me at 955-5007 or by email at dalew@keatscon.com.

Sincerely,

Dale A. Walters, CPA, PFS, CFP

TITLE 14. PUBLIC SERVICE CORPORATIONS; CORPORATIONS AND ASSOCIATIONS; SECURITIES REGULATION

CHAPTER 6. INVESTMENT MANAGEMENT

ARTICLE 1. GENERAL PROVISIONS RELATING TO THE ARIZONA INVESTMENT MANAGEMENT ACT

ARTICLE 2. DUTIES OF INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES

R14-6-209. Financial and ~~D~~disciplinary ~~I~~information that ~~I~~investment ~~A~~advis~~o~~ers ~~Must~~Shall ~~D~~disclose to ~~C~~clients

R14-6-210. Solicitation

ARTICLE 1. GENERAL PROVISIONS RELATING TO THE ARIZONA INVESTMENT MANAGEMENT ACT

R14-6-101. Definitions

A. The definitions set forth in A.R.S. §§ 44-1801 and 44-3101 shall apply to the rules promulgated under Chapter 13.

B. The following definitions shall apply to all rules promulgated under Chapter 13 unless the context otherwise requires:

1. "Advertisement" means, except as set forth in subsections (d) and (e), any notice, circular, letter, or other written, oral, or electronically-generated communication addressed to or reasonably designed by the investment adviser or investment adviser representative to be accessed by more than 1 person, or any notice or other announcement in any publication or by radio or television, ~~which~~that directly or indirectly offers:

1-10 written not less one

a. Any analysis, report, or publication concerning securities, or ~~which~~that is to be used in making any determination as to when to buy or sell any security, or which security to buy or sell; or

b. Any graph, chart, formula, or other device to be used in making any determination as to when to buy or sell any security, or which security to buy or sell; or

c. Any other investment advisory service with regard to securities; or

d. A communication over a computer on-line service including, but not limited to, an electronic bulletin board shall not be deemed to be an advertisement when an investment adviser or an investment adviser representative is either:

i. Engaged in a discussion regarding securities and does not receive compensation from any person for the discussion; or

ii. Responds to unsolicited inquiries regarding the provision of investment advisory services.

e. A communication by one or more investment advisers or investment adviser representatives shall not be deemed to be an advertisement when the communication is addressed solely to or is reasonably designed to be accessed solely by other investment advisers or investment adviser representatives.

Indention should be consistent. #1 was indented 2 1/4 inches #s 3-7 were indented 3 1/2 inches

Make up your mind if you are indenting 1st line or not. Compare to #1

3. "Certified public accountant" or "CPA" means an accountant who has been registered or licensed to practice public accounting and is permitted to use the title "certified public accountant" and to use the initials "CPA" after the accountant's name.

4. "Chapter 13" means A.R.S. Title 44, Chapter 13.

~~5. "Commodity Exchange Act" means 7 U.S.C. 1 *et seq.* (1988 & Supp. V 1993), which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of State. Copies of the Commodity Exchange Act are available from the Securities Division of the Corporation Commission and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.~~

~~6. "Division" means the Securities Division of the Corporation Commission.~~

4 ~~75~~. "Fixed fee basis" means an investment advisory fee ~~which~~that at any given time can be precisely established in a dollar amount without regard to the investment performance or value of an account and ~~which~~that is not based on the purchase or sale of specific securities.

5 ~~86~~. "Form ADV" means the Uniform Application for Investment Adviser Registration, 17 CFR 279.1 (1994 close) (Form amended at ~~59 FR 21657 (1994) and 59 FR 27659 (1994)~~62 FR 28136 (1997) and 62 FR 33008 (1997))~~, which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of State. Copies of Form ADV are available from the Division and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402~~.

6 ~~87~~. "IM Act" means the Arizona Investment Management Act, A.R.S. § 44-3101 *et seq.*

7 ~~28~~. "Impersonal advisory services" means investment advisory services provided solely:

a. By means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts, (or)?

b. Through the issuance of statistical information containing no expression of opinion as to the investment merits of a particular security; or

c. Any combination of the foregoing services.

8. "Investment-related" means pertaining to securities, commodities, banking, insurance, or real estate, including but not limited to acting as or being associated with a broker-dealer, investment company, investment adviser, government securities broker or

dealer, municipal securities dealer, bank, savings and loan association, entity, or person required to be registered under the Commodity Exchange Act, or fiduciary.

9. "Involved" means acting or aiding, abetting, causing, counseling, commanding, inducing, conspiring with, or failing reasonably to supervise another in doing an act.

10. "Management person" means a person with power to exercise, directly or indirectly, a controlling influence over the management or policies of an investment adviser that is a company or to determine the general investment advice given to clients.

11~~0~~. "NASAA" means the North American Securities Administrators Association, Inc., or any successor organization.

12~~1~~. "NASD" means the National Association of Securities Dealers, Inc., or any successor organization.

13~~2~~. "Relative" means any relationship by blood, marriage, or adoption, not more remote than ~~1st~~first cousin.

14~~3~~. ~~"Rule 204-2" means United States Securities and Exchange Commission Rule 204-2, 17 CFR 275.204-2 (1994), which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of State. Copies of Rule 204-2 are available from the Division and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.~~

~~14. "Rule 204-3" means United States Securities and Exchange Commission Rule 204-3, 59 FR 21661 (1994) (to be codified at 17 CFR 275.204-3), which is incorporated by reference, does not contain any later amendments or editions, and is on file in the Office of the Secretary of State. Copies of Rule 204-3 are available from the Division~~

~~and from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402.~~

14/ ~~15.~~ "SEC" means United States Securities and Exchange Commission.

16~~5~~. "Securities Act" means the Securities Act of Arizona, A.R.S. § 44-1801 *et seq.*

16. "Self-regulatory Organization" or "SRO" means any national securities or commodities exchange, registered association, or registered clearing agency.

17. "Unincorporated organization" includes a limited liability company for purposes of the definition of "person," as defined in A.R.S. § 44-1801(13~~4~~).

18. "Wrap fee program" means a program under which any client is charged a specified fee or fees not based directly upon transactions in a client's account for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and execution of client transactions.

R14-6-102. **Scope of ~~this Article~~provisions**

The following ~~rules~~Sections are adopted by the Commission under the authority granted pursuant to Chapter 13. ~~All rules~~Such Sections shall be generally applicable to the administration of the IM Act, but the Commission may at any time abrogate or waive strict adherence to any particular ~~rule~~provision ~~in any specific instance where~~when the Commission ~~may~~ deems it advisable for the equitable administration of the law. When not in conflict with these ~~rules~~Sections, the applicable provisions of A.A.C. R14-3-101 through R14-3-113 also shall apply.

R14-6-103. **Severability**

The provisions of the ~~rules~~Sections promulgated under Chapter 13 are severable. If any provision of a ~~rule~~Section is held to be invalid, such invalidity shall not affect other provisions ~~which~~that can be given effect without the invalid provision.

R14-6-104. Enforcement of the Arizona Investment Management Act

The ~~rules~~provisions relating to investigations and examinations conducted pursuant to and orders issued under the IM Act are contained at A.A.C. R14-4-301 through R14-4-308.

ARTICLE 2. DUTIES OF INVESTMENT ADVISERS AND INVESTMENT ADVISER REPRESENTATIVES

R14-6-201. Books and ~~R~~records of ~~I~~investment ~~A~~advisers

A. ~~Each investment adviser shall make, maintain, and preserve books and records in compliance with Rule 204-2. The investment adviser shall concurrently file with the Commission a copy of any notices or written undertakings required to be filed with the SEC under Rule 204-2.~~

B. ~~To the extent that the SEC amends Rule 204-2, investment advisers in compliance with Rule 204-2 as amended shall not be deemed to be in violation of this Section and shall not be subject to enforcement action by the Commission for violation of this Section to the extent that the violation results solely from the investment adviser's compliance with the amended Rule 204-2.~~

C. ~~As of the effective date of this Section, e~~Each investment adviser shall make, maintain, and preserve ~~for at least 5 years the~~ following ~~additional~~ books and records:

1. A journal or journals, including cash receipts and disbursements records, and any other records of original entry forming the basis of entries in any ledger.

2. General and auxiliary ledgers (or other comparable records) reflecting asset, liability, reserve, capital, income, and expense accounts.

3. A memorandum of each order given by the investment adviser or any investment adviser representative of the investment adviser for the purchase or sale of any

security, of any instruction received by the investment adviser or any investment adviser representative of the investment adviser from the client concerning the purchase, sale, receipt, or delivery of a particular security, and of any modification or cancellation of any such order or instruction. Such memoranda shall show the terms and conditions of the order, instruction, modification, or cancellation; shall identify the person connected with the investment adviser who recommended the transaction to the client and the person who placed such order; and shall show the account for which entered, the date of entry, and the bank, broker, or dealer by or through whom executed where appropriate. Orders entered pursuant to the exercise of discretionary power shall be so designated.

4. All check books, bank statements, cancelled checks, and cash reconciliations of the investment adviser.

5. All bills or statements (or copies thereof), paid or unpaid, relating to the business of the investment adviser.

6. All trial balances, financial statements, and internal audit working papers relating to the business of the investment adviser.

7. Originals of all written communications received and copies of all written communications sent by such investment adviser or any investment adviser representative of the investment adviser relating to any recommendation made or proposed to be made and any advice given or proposed to be given; any receipt, disbursement, or delivery of funds or securities; or the placing or execution of any order to purchase or sell any security. If the investment adviser or any investment adviser representative of the investment adviser sends any notice, circular, or other

advertisement offering any report, analysis, publication, or other investment advisory service to more than 10 persons, the investment adviser shall not be required to keep a record of the names and addresses of the persons to whom it was sent; except that if such notice, circular, or advertisement is distributed to persons named on any list, the investment adviser shall retain with the copy of such notice, circular, or advertisement a memorandum describing the list and the source thereof.

8. A list or other record of all accounts in which the investment adviser or any investment adviser representative of the investment adviser is vested with any discretionary power with respect to the funds, securities, or transactions of any client.

9. All powers of attorney and other evidences of the granting of any discretionary authority by any client to the investment adviser or any investment adviser representative of the investment adviser, or copies thereof.

10. All written agreements (or copies thereof) entered into by the investment adviser with any client or otherwise relating to the business of such investment adviser as such.

11. A copy of each notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication that the investment adviser circulates or distributes, directly or indirectly, to ~~10~~ ten or more persons (other than persons connected with such investment adviser), and if such notice, circular, advertisement, newspaper articles, investment letter, bulletin, or other communication recommends the purchase or sale of a specific security and does not state the reasons for such recommendation, a memorandum of the investment adviser indicating the reasons therefor.

12. A record of every transaction in a security in which the investment adviser or any investment adviser representative of such investment adviser has, or by reason of such

transaction acquires, any direct or indirect beneficial ownership, except transactions effected in any account over which neither the investment adviser nor any investment adviser representative of the investment adviser has any direct or indirect influence or control and transactions in securities that are direct obligations of the United States. Such record shall state the title and amount of the security involved; the date and nature of the transaction (i.e., purchase, sale, or other acquisition or disposition); the price at which it was effected; and the name of the broker, dealer, or bank with or through whom the transaction was effected. Such record may also contain a statement declaring that the reporting or recording of any such transaction shall not be construed as an admission that the investment adviser or investment adviser representative has any direct or indirect beneficial ownership in the security. A transaction shall be recorded not later than 10 days after the end of the calendar quarter in which the transaction was effected.

13. Notwithstanding the provisions of subsection (12) above, where the investment adviser is primarily engaged in a business or business other than advising registered investment companies or other advisory clients, a record must be maintained of every transaction in a security in which the investment adviser or any investment adviser representative of such investment adviser has, or by reason of such transaction acquires, any direct or indirect beneficial ownership, except transactions effected in any account over which neither the investment adviser nor any investment adviser representative of the investment adviser has any direct or indirect influence or control; and transactions in securities that are direct obligations of the United States. Such record shall state the title and amount of the security involved; the date and nature of

One sentence too long!

the transaction (i.e., purchase, sale, or other acquisition or disposition); the price at which it was effected; and the name of the broker, dealer, or bank with or through whom the transaction was effected. Such record may also contain a statement declaring that the reporting or recording of any such transaction shall not be construed as an admission that the investment adviser or investment adviser representative has any direct or indirect beneficial ownership in the security. A transaction shall be recorded not later than 10 days after the end of the calendar quarter in which the transaction was effected.

14. A copy of each written statement and each amendment or revision thereof, given or sent to any client or prospective client of such investment adviser in accordance with the provisions of Section 14-6-205, and a record of the dates that each written statement, and each amendment or revisions thereof, was given or offered to be given, to any client or prospective client who subsequently becomes a client.

15. All written acknowledgments of receipt from the client of the investment adviser's written disclosure statements, any solicitors' written disclosure documents, and copies of the disclosure documents delivered to the clients.

16. All accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin, or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connection with such investment adviser); provided, however, that, with respect to the performance of managed

accounts, the retention of all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts shall be deemed to satisfy the requirements of this paragraph.

indent same as others

1.17. A file containing each customer complaint received relating to advisory activities conducted by the investment adviser, its investment advisory representatives, or its employees, and all correspondence relating to such complaint;

#s 1-16 did not use)

2.18. A file containing all advertisements used by the investment adviser or any investment adviser representative, including any radio or television transcripts and advertisements placed on computer or electronic bulletin boards;

3.19. In each client file, all correspondence received or sent by the investment adviser, any investment adviser representative, or any employee, that relates to any client account, securities, or funds.

~~D~~B. If an investment adviser subject to subsection (A) has custody or possession of securities or funds of any client, the records required to be made and kept under subsection (A) shall include:

1. A journal of other record showing all purchases, sales, receipts, and deliveries of securities (including certificate numbers) for such accounts and all other debits and credits to such accounts.

2. A separate ledger account for each such client showing all purchases, sales, receipts, and deliveries of securities, the date and price of each such purchase and sale, and all debits and credits.

3. Copies of confirmations of all transactions effected by or for the account of any such client.

4. A record for each security in which any such client ahs a position, which record shall show the name of each such client having any interest in each security, the amount or interest of each such client, and the location of each such security.

C. Every investment adviser subject to subsection (A) who renders, or whose investment adviser representative renders, any investment supervisory or management service to any client shall, with respect to the portfolio being supervised or managed and to the extent that the information is reasonably available to or obtainable by the investment adviser, make and keep true, accurate, and current:

1. Records showing separately for each client the securities purchased and sold, and the date, amount, and price of each purchase and sale.

2. For each security in which any client has a current position, information from which the investment adviser can promptly furnish the name of each client and the current amount or interest of the client.

D. Any books or records required by this Section may be maintained by the investment adviser in such manner that the identity of any client to whom such investment adviser renders investment supervisory services is indicated by numerical or alphabetical code or some similar designation.

E. ~~Books and records that are required to be maintained pursuant to subsection (A) shall be available for inspection by the Commission in accordance with the provisions of Rule 204-2. Books and records that are required to be maintained pursuant to subsection (C) shall be readily accessible and may be preserved in accordance with Rule 204-2(g).~~ All

books and records required to be maintained under the provisions of this Section shall be maintained and preserved in an easily accessible place for a period of not less than 5 years from the end of the fiscal year during which the last entry was made on such record or the record was last published or disseminated, the first 2 years in an appropriate office of the investment adviser.

F. The investment adviser shall maintain entity organizational documents and any amendments thereto, minute books, and stock certificate books of the investment adviser and of any predecessor in the principal office of the investment adviser and shall preserve such records until at least 3 years after termination of the enterprise.

G. An investment adviser subject to subsection (A), before ceasing to conduct or discontinuing business as a investment adviser, shall arrange for and be responsible for the preservation of the books and records required to be maintained and preserved under this Section for the remainder of the period specified in this Section, and shall notify the Division in writing of the exact address where such books and records will be maintained.

H. The records required to be maintained and preserved under this Section may be immediately produced or reproduced by photograph on film or on magnetic disk, tape, or other computer storage medium and be maintained and preserved for the required time in that form. If records are produced or reproduced by photographic film or computer storage medium, the investment adviser shall:

1. Arrange the records and index the films or computer storage medium so as to permit the immediate location of any particular record.

2. Be ready at all times to provide, and promptly provide, any facsimile enlargement of film or computer printout or copy of the computer storage medium which the Division may request.

3. Store separately from the original one other copy of the film or computer storage medium for the time required.

4. With respect to records stored on computer storage medium, maintain procedures for maintenance and preservation of, and access to, records so as to reasonably safeguard records from loss, alteration, or destruction,.

5. With respect to records stored on photographic film, at all times have available facilities for immediate, easily readable projection of the film and for production of easily readable facsimile enlargements.

R14-6-202. Supervision

For purposes of A.R.S. § 44-3201(A)(12), no investment adviser shall be deemed to have failed to reasonably supervise its investment adviser representatives or employees if:

1. There ~~have been~~ investment adviser has established and maintained written procedures, and a system for applying such procedures, ~~which~~that ~~would~~ reasonably may be expected to prevent and detect, insofar as practicable, any violation of the IM Act or any rule adopted thereunder by such investment adviser representatives or employees ~~of the IM Act, or any rule adopted thereunder~~; and

2. Such investment adviser has ~~reasonably~~ discharged reasonably the duties and obligations incumbent upon it by reason of such procedures and system without reasonable cause to believe that the investment adviser representatives or employees are not complying with such procedures and system ~~were not being complied with~~.

R14-6-203. Dishonest and ~~U~~unethical ~~P~~practices

"Dishonest and unethical practices~~"~~," with respect to investment advisers and investment adviser representatives under A.R.S. § 44-3201(A)(13), shall include~~,~~ but not be limited to~~,~~ the following:

1. Refusing to allow or otherwise impeding ~~designees of~~ the Commission from conducting an investigation or examination under the IM Act or any rule adopted thereunder; Be consistent! sometimes "; " sometimes "; and/or " and sometimes ".
2. Placing an order to purchase or sell a security for the account of a client without authority to do so;
3. Placing an order to purchase or sell a security for the account of a client upon instruction of a ~~3rd~~third party without first obtaining a written ~~3rd~~third-party trading authorization from the client;
4. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without first obtaining written discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of specified securities shall be executed, or both;
5. Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives, and character of the account;
6. Borrowing money or securities from a client or client's account unless the client has authorized the borrowing and is a dealer, an affiliate, or relative of the investment adviser or investment adviser representative, or a financial institution or other entity engaged in the business of loaning funds or securities;

7. Loaning money to a client unless the investment adviser or investment adviser representative is a financial institution or other entity engaged in the business of loaning funds or the client is an affiliate or relative of the investment adviser or investment adviser representative;

8. Misrepresenting to any client, or prospective client, the qualifications of the investment adviser, the investment adviser representative, or an employee, or misrepresenting the nature of the investment advisory services being offered or fees to be charged for such services, or omitting to state a material fact necessary to make the statements made regarding qualifications, services, or fees, in light of the circumstances under which they were made, not misleading;

9. Providing a report or recommendation to any client prepared by someone other than the investment adviser or investment adviser representative without disclosing that fact. This prohibition does not apply to a situation where the investment adviser or investment adviser representative uses published research reports or statistical analyses to render investment advice or where the investment adviser or investment adviser representative orders such a report in the ordinary course of providing service;

10. Charging a client an investment advisory fee that is unreasonable in light of the type of services to be provided, the experience and expertise of the investment adviser or the investment adviser representative, and the sophistication and bargaining power of the client~~, and whether the investment adviser has disclosed that lower fees for comparable services may be available from other sources~~;

11. Failing to disclose to a client in writing before entering into or renewing an investment advisory agreement with that client, or before any investment advice is rendered, any

material conflict of interest relating to the investment adviser, the investment adviser representative, or an employee ~~which~~that could reasonably be expected to impair the rendering of unbiased and objective advice including~~,~~ but not limited to:

a. Compensation arrangements connected with investment advisory services to clients ~~which~~that are in addition to compensation from such clients for those services; and

b. Charging a client an investment advisory fee for rendering investment advice without disclosing that compensation for executing securities transactions pursuant to such investment advice will be received by the investment adviser, the investment adviser representative, or an employee;

12. Promising or guaranteeing a client that a gain, loss, or other outcome will be achieved as a result of the investment advice;

13. Disclosing the identity, affairs, or investments of a client to any ~~3rd~~third party unless required by law to do so~~,~~ or ~~unless~~ consented to by the client;

14. With respect to any client initially retained after the effective date of this rule, entering into, extending, modifying, or renewing any investment advisory contract except a contract for impersonal advisory services unless such contract is in writing and discloses all the material terms of the contract including but not limited to the services to be provided, the investment advisory fee or the formula for computing the fee, the amount or the manner of calculation of the amount of the prepaid fee to be returned in the event of contract termination or non-performance, and ~~of any~~the grant of any discretionary power to the investment adviser;

15. With respect to any client initially retained after the effective date of this rule, entering into, extending, modifying, or renewing any investment advisory contract without disclosing, in writing to the client, any affirmative answers to disciplinary questions numbered 11A and 11K in Part I of the Form ADV;

16. Entering into, extending, modifying, or renewing any investment advisory contract ~~which~~that allows the assignment of such contract by the investment adviser without the prior written consent of the client;

17. Committing any act that results in denial, revocation, or suspension by an agency of any state of a license or registration relating to securities ~~by an agency of any state~~, where such denial, revocation, or suspension arises out of any scheme, act, practice, or course of business that operates or would operate as ~~a~~ fraud or deceit, or arises out of a violation of Article 13 of the Securities Act or the rules promulgated thereunder; and

18. ~~For any investment adviser to, in any manner, request, or require, in any contract, agreement, or otherwise, any condition, stipulation, or provision binding on~~ Requesting or requiring any person to waive compliance with any provision of the IM Act or the rules thereunder. Any such waiver shall be void.

R14-6-204. Written ~~E~~examination

A. Prior to licensure, except as provided in subsection (B), each investment adviser who is an individual and each investment adviser representative~~, each of whom is hereafter referred to as an "applicant,"~~ ~~must~~shall take and receive a score of at least 70% on:

1. The NASAA Series 65 Uniform Investment Adviser State Law Examination or Series 66 Combined State Law Examination; and

2. The NASD Series 7 General Securities Registered Representative Examination or Series 2 General Securities Representative (Non-member) Examination.

B. The examinations described in subsection (A)(2) shall not be required of an investment adviser or an investment adviser representative ~~applicant~~ who has completed and maintains one of the following credentials:

1. Certified Financial Planner (CFP) designation awarded by the Certified Financial Planner Board of Standards, Inc.; or
2. Chartered Financial Analyst (CFA) designation awarded by the Institute of Chartered Financial Analysts; or
3. Chartered Financial Consultant (ChFC) designation awarded by the American College, Bryn Mawr, Pennsylvania; or
4. Chartered Investment Counselor (CIC) designation awarded by the Investment Counsel Association of America, Inc.; (or) either remove this (my suggestion) or add above
5. Personal Financial Specialist (PFS) designation awarded by the American Institute of Certified Public Accountants.

C. In the event that the NASAA or NASD Series examination numbers change, the most current examination series deemed applicable by the Commission to the category of licensure shall apply.

D. In the event that the title changes for any of the credentials designated in subsection (B), the title deemed applicable by the Commission shall apply.

R14-6-205. Information to be ~~F~~furnished to ~~C~~clients ("Brochure Rule")

A. Each investment adviser shall ~~comply with the provisions of Rule 204-3~~ furnish each client and prospective client with a written disclosure statement that may be either a copy of Part

II of its Form ADV or a written document containing at least the information required by Part II of Form ADV.

~~B. To the extent that the SEC amends Rule 204-3, investment advisers in compliance with Rule 204-3 as amended shall not be deemed to be in violation of this Section and shall not be subject to enforcement action by the Commission for violation of this Section to the extent that the violation results solely from the investment adviser's compliance with the amended Rule 204-3.~~

B. The information required to be disclosed by subsection (A) shall be disclosed to clients not less than 48 hours prior to entering into any written or oral investment advisory contract, or no later than the time of entering into such contract if the client has the right to terminate the contract without penalty within five business days after entering into the contract.

C. An investment adviser need not deliver the statement required by subsection (A) in connection with entering into an investment company contract or a contract for impersonal advisory services. The investment adviser shall, however, offer in writing to deliver the statement within seven business days upon receipt of a written request.

D. Without charge and to each of its clients, an investment adviser annually shall deliver or offer in writing to deliver the statement required by this Section within seven business days upon receipt of a written request.

E. If an investment adviser renders substantially different types of investment advisory services to different clients, any information required by Part II of Form ADV may be omitted from the statement furnished to the client or prospective client if such information is applicable only to a type of investment advisory service or fee that is not rendered or charged, or proposed to be rendered or charged, to that client or prospective client.

F. Nothing in this Section shall relieve any investment adviser from any obligation pursuant to any provision of the IM Act or the rules and regulations thereunder or other federal or state law to disclose any information to is clients or prospective clients not specifically required by this Section.

G. An investment adviser that is compensated under a wrap fee program for sponsoring, organizing, or administering the program, or for selecting, or providing advice to clients regarding the selection of, other investment advisers in the programs, shall, in lieu of the written disclosure statement required by subsection (A) and in accordance with the other subsections of this Section, furnish each client and prospective client of the wrap fee program with a written disclosure statement containing at least the information required by Schedule H of Form ADV. Any additional information included in such disclosure shall be limited to information concerning wrap fee programs sponsored by the investment adviser.

H. If the investment adviser is required under subsection (G) to furnish disclosure statements to clients or prospective clients of more than one wrap fee program, the investment adviser may omit from the disclosure statement furnished to clients and prospective clients of a wrap fee program or programs any information required by Schedule H that is not applicable to clients or prospective clients of that wrap fee program or programs.

I. An investment adviser need not furnish the written disclosure statement required by subsection (G) to clients and prospective clients of a wrap fee program if another investment adviser is required to furnish and does furnish the written disclosure statement to all clients and prospective clients of the wrap fee program.

R14-6-206. Custody of ~~C~~client ~~F~~funds or ~~S~~securities by ~~I~~investment ~~A~~advisers

It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser to take or have custody of any securities or funds of any client unless:

1. The investment adviser notifies the Commission in writing that the investment adviser has or may have custody of client funds or securities. Such notification may be given on Form ADV;
2. The securities of each client are segregated, marked to identify the particular client having the beneficial interest therein, and held in safekeeping in some place reasonably free from risk of destruction or other loss;
3. All client funds are deposited in ~~1~~ one or more bank or similar accounts containing only clients' funds, such accounts are maintained in the name of the investment adviser as agent or trustee for such clients, and the investment adviser maintains a separate record for each such account showing the name and address of the bank or similar institution where the account is maintained, the dates and amounts of deposits into and withdrawals from the account, and the exact amount of each client's beneficial interest in the account;
4. Immediately after accepting custody or possession of funds or securities from any client, the investment adviser notifies the client in writing of the place where and the manner in which the funds and securities will be maintained and, subsequently, if and when there is a change in the place where or the manner in which the funds or securities are maintained, the investment adviser gives written notice to the client within ~~prompt (but in no event more than 10~~ ten business days~~) written notice thereof to the client~~;

5. At least once every three months, the investment adviser sends each client an itemized statement showing the client's funds and securities in the investment adviser's custody at the end of such period and all debits, credits, and transactions in the client's account during such period; and

6. At least once every calendar year, an independent CPA or public accountant verifies all client funds and securities by actual examination at a time chosen by the independent CPA or public accountant without prior notice to the investment adviser. The independent CPA's or public accountant's report stating that such CPA or public accountant has made an examination of such funds and securities, and describing the nature and extent of the examination, shall be filed with the Commission ~~promptly (but in no event more than~~within 30 calendar days~~)~~ after ~~each such~~the examination.

R14-6-207. Suitability of ~~I~~investment ~~A~~advisory ~~S~~services

It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any person ~~providing investment advisory services~~ to provide investment advisory services to any client, other than in connection with impersonal advisory services, unless the person:

1. Before providing any investment advisory services, and as appropriate thereafter, makes a reasonable inquiry of the client as to the financial situation, investment experience, and investment objectives of the client; and

2. Reasonably determines that the investment advisory services are suitable for the client based upon the information obtained from the client in accordance with subsection (1) above.

R14-6-208. Advertisements by ~~I~~investment ~~A~~advisers or ~~I~~investment ~~A~~adviser ~~R~~representatives

A. It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser or investment adviser representative, directly or indirectly, to use any advertisement:

1. Which refers, directly or indirectly, to any testimonial of any kind concerning the investment adviser or investment adviser representative or concerning any advice, analysis, report, or other service rendered by such investment adviser or investment adviser representative~~; or~~.

2. Which refers, directly or indirectly, to past specific recommendations of ~~such~~the investment adviser or investment adviser representative ~~which~~that were or would have been profitable to any person; ~~provided, however, that this shall not prohibit an advertisement which sets out or offers to~~ except that an investment adviser or investment adviser representative may furnish or offer to furnish a list of all recommendations made by ~~such~~the investment adviser or investment adviser representative within the immediately preceding period of not less than one year ~~if such advertisement, and such list~~ if the investment adviser or investment adviser representative also~~it is~~ furnished~~s separately~~:

a. ~~States t~~The name of each ~~such~~ security recommended, the date and nature of each ~~such~~ recommendation (for example, whether to buy, sell, or hold), the market price at that time, the price at which the recommendation was to be acted upon, and the most recently available market price of each such security ~~as of the most recent practicable date~~; and

b. ~~Contains t~~The following ~~cautionary~~ legend on the ~~1st~~first page ~~thereof~~ in print or type as large as the largest print or type used in the body or text ~~thereof~~: "It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list~~;~~." ~~or~~

3. Which represents, directly or indirectly, that any graph, chart, formula, or other device being offered can in and of itself be used to determine which securities to buy or sell, or when to buy or sell them; or which represents, directly or indirectly, that any graph, chart, formula, or other device being offered will assist any person in making ~~his or her~~that person's own decisions as to which securities to buy or sell, or when to buy or sell them, without prominently disclosing in such advertisement the limitations thereof and the difficulties with respect to its use~~; or~~.

4. Which represents, directly or indirectly, that~~contains any statement to the effect that~~ any report, analysis, or other service will be furnished for free or without charge, unless such report, analysis, or other service actually is or will be furnished entirely free and without any direct or indirect condition or obligation. ~~, directly or indirectly; or~~

5. Which states that the Commission has approved any advertisement.

B. When requested by the Commission, any advertisement used directly or indirectly in connection with the provision of investment advisory services shall be filed with the Commission at least ~~10~~ 10 business days prior to its proposed use.

C. Any advertisement that has been requested by the Commission pursuant to the provisions of subsection (B) but that has not been filed with the Commission shall not be used.

R14-6-209. Financial and ~~D~~disciplinary ~~I~~information that ~~I~~investment ~~A~~advisers ~~Must~~Shall ~~D~~disclose to ~~C~~clients

A. ~~The following definitions shall apply to this Section:~~

~~1. "Investment-related" means pertaining to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, investment company, investment adviser, government securities broker or dealer, municipal securities dealer, bank, savings and loan association, entity, or person required to be registered under the Commodity Exchange Act, or fiduciary).~~

~~2. "Involved" means acting or aiding, abetting, causing, counseling, commanding, inducing, conspiring with, or failing reasonably to supervise another in doing an act.~~

~~3. "Management person" means a person with power to exercise, directly or indirectly, a controlling influence over the management or policies of an investment adviser which is a company or to determine the general investment advice given to clients.~~

~~4. "Self-regulatory Organization" or "SRO" means any national securities or commodities exchange, registered association, or registered clearing agency.~~

~~B.~~ It shall constitute a fraudulent practice within the meaning of A.R.S. § 44-3241(A)(4) for any investment adviser to fail to disclose to any client or prospective client all material facts with respect to:

1. A financial condition of the investment adviser that is reasonably likely to impair the ability of the investment adviser to meet contractual commitments to clients, if the investment adviser has discretionary authority (express or implied) or custody over ~~such~~the client's funds or securities, or requires prepayment of advisory fees of more than $500 from such client, 6 months or more in advance; or

2. A legal or disciplinary event that is material to an evaluation of the investment adviser's or an investment adviser representative's integrity or ability to meet contractual commitments to clients.

~~C~~B. It shall constitute a rebuttable presumption that the following legal or disciplinary events involving the investment adviser, an investment adviser representative, or a management person of the investment adviser (any of the foregoing being referred to hereafter as a "person") that were not resolved in the person's favor or subsequently reversed, suspended, or vacated are material within the meaning of subsection (~~B~~A)(2) for a period of ~~10~~ ten years from the time of the event. No affirmative or negative presumption of materiality shall be created under subsection (~~B~~A)(2) for events not specifically set forth in this subsection.

1. A criminal or civil action in a court of competent jurisdiction in which the person:

   a. Was convicted~~,~~ or pleaded guilty or nolo contendere ("no contest") to a felony or misdemeanor, or is the named subject of a pending criminal proceeding (any of the foregoing referred to hereafter as "action"), and such action involved: an investment-related business; fraud, false statements, or omissions; wrongful taking of property; or bribery, forgery, counterfeiting, or extortion;

   b. Was found to have been involved in a violation of an investment-related statute or rule; or

   c. Was the subject of any order, judgment, or decree permanently or temporarily enjoining the person ~~from,~~ or otherwise limiting the person from~~,~~ engaging in any investment-related activity.

2. An administrative proceeding before the SEC~~Securities and Exchange Commission~~, the Commission, or any federal or state~~regulatory~~ agency ~~or any state agency~~ (any of the foregoing being referred to hereafter as "agency") in which the person:

   a. Was found to have caused an investment-related business to lose its authorization to do business; or

   b. Was found to have been involved in a violation of an investment-related statute or rule, and was the subject of an order by the agency denying, suspending, or revoking the authorization of the person to act in, or barring or suspending the person's association with, an investment-related business; or otherwise significantly limiting the person's investment-related activities.

3. ~~Self-regulatory Organization ("~~SRO~~")~~ proceedings in which the person:

   a. Was found to have caused an investment-related business to lose its authorization to do business; or

   b. Was found to have been involved in a violation of the SRO's rules and was the subject of an order by the SRO barring or suspending the person from membership or from association with other members, or expelling the person from membership; fining the person more than $2,500; or otherwise significantly limiting the person's investment-related activities.

~~D~~C. The information required to be disclosed by subsection (~~B~~A) shall be disclosed to clients ~~promptly but in no event later than~~within 30 calendar days after the occurrence of the event requiring disclosure, and to prospective clients not less than 48 hours prior to entering into any written or oral investment advisory contract, or no later than the time of entering into

such contract if the client has the right to terminate the contract without penalty within ~~5~~ five business days after entering into the contract.

~~E~~D. For purposes of calculating the ~~10~~ ten-year period during which events are presumed to be material under subsection (~~C~~B), the date of the reportable event shall be the date on which the final order, judgment, or decree was entered, or the date on which any rights of appeal from preliminary orders, judgments, or decrees lapsed.

~~F~~E. Compliance with subsection (~~C~~B) shall not relieve any investment adviser from the disclosure obligations of subsection (~~B~~A); compliance with subsection (~~B~~A) shall not relieve any investment adviser from any other disclosure requirement under the IM Act, the rules thereunder, or under any other state or federal law. Note: Investment advisers may disclose this information to clients and prospective clients in their "brochure," the written disclosure statement to clients under R14-6-205, provided, that the delivery of the brochure satisfies the timing of disclosure requirements described in subsection (~~D~~C).

R14-6-210. Solicitation

A. For purposes of A.R.S. § 44-3101(3)(d), an individual shall not be deemed to have solicited for the sale of investment advisory services if the individual:

1. Does not on a regular basis give advice regarding, or recommend the services of, an investment adviser or an investment adviser representative; and
2. Does not accept or receive directly or indirectly any commission, fee, or other remuneration in connection with a referral to or recommendation of the services of an investment adviser or an investment adviser representative.

B. The term "remuneration" shall be broadly construed, but shall not include the exchange of client referrals between professionals without an exchange of additional compensation.

C. No individual or entity subject to an order or finding that denies, revokes, or suspends licensure or registration under the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, the Securities Act, or the IM Act may solicit for the sale of investment advisory services.

EXHIBIT B

NASAA

INTERPRETIVE ORDER CONCERNING BROKER-DEALERS, INVESTMENT ADVISERS, BROKER-DEALER AGENTS AND INVESTMENT ADVISER REPRESENTATIVES USING THE INTERNET FOR GENERAL DISSEMINATION OF INFORMATION ON PRODUCTS AND SERVICES

Adopted April 27, 1997

WHEREAS the [Administrator] (the "Administrator") is charged with the administration of [name of state securities act], the (Jurisdiction's) Uniform Securities Act (the "Act") and Sections 000, *et seq.* of the Regulations of the Jurisdiction promulgated under the Act;

WHEREAS, at Section 412(a) of the Act, it is provided, in part, that "[t]he [Administrator] may from time to time make, amend and rescind such ... orders as necessary to carry out the provisions of this act ...;"

WHEREAS, at Section 201(a) of the Act, it is provided "[i]t is unlawful for any person to transact business in this state as a broker-dealer or agent unless he is registered under this act...;"

WHEREAS, at Section 201(c) of the Act, it is further provided "[i]t is unlawful for any person to transact business in this state as an investment adviser unless ... he is so registered under this act...;" [Note: may also insert similar provision governing investment adviser agents/representatives]

WHEREAS the [Administrator] acknowledges that the Internet, the World Wide Web, and similar proprietary or common carrier electronic systems (collectively, the "Internet") have facilitated greatly the ability of broker-dealers, investment advisers, broker-dealer agents and investment adviser agents/representatives to advertise and otherwise disseminate information on products and services to prospective customers and clients;

WHEREAS the [Administrator] also acknowledges that certain communications made on the Internet are directed generally to anyone having access to the Internet and may be transmitted through postings on Bulletin Boards, displays on "Home Pages" or similar methods (hereinafter, "Internet Communications");

WHEREAS the [Administrator] further acknowledges that in certain instances, by distributing information on available products and services through Internet Communications available to persons in this state, broker-dealers, investment advisers, their broker-dealer agents and their investment adviser agents/representatives could be construed as "transacting business" for purposes of Sections 201(a) and 201(c) of the Act so as to require registration in this state, since the Internet Communications would be received in this state regardless of the intent of the person originating such communication, and

WHEREAS the [Administrator] finds that the issuance of this Order is necessary and appropriate in

the public interest and for the protection of investors and consistent with the purposes fairly intended by the policy and provisions of the Act;

NOW THEREFORE, IT IS HEREBY ORDERED as follows:

1. Broker-dealers, investment advisers, broker-dealer agents (hereinafter "BD agents") and investment adviser agents/representatives (hereinafter "IA reps") who use the the Internet, the World Wide Web, and similar proprietary or common carrier electronic systems (collectively, hereinafter the "Internet") to distribute information on available products and services through certain communications made on the Internet directed generally to anyone having access to the Internet, and transmitted through postings on Bulletin Boards, displays on "Home Pages" or similar methods (hereinafter, "Internet Communications") shall not be deemed to be "transacting business" in this state for purposes of Sections 201(a) and 201(c) of the Act base d solely on that fact if the following conditions are observed:

A. The Internet Communication contains a legend in which it is clearly stated that

(1) the broker-dealer, investment adviser, BD agent or IA rep in question may only transact business in this state if first registered, excluded or exempted from state broker-dealer, investment adviser, BD agent or IA rep registration requirements, as may be; and

(2) follow-up, individualized responses to persons in this state by such broker-dealer, investment adviser, BD agent or IA rep that involve either the effecting or attempting to effect transactions in securities, or the rendering of personalized investment advice for compensation, as may be, will not be made absent compliance with state broker-dealer, investment adviser, BD agent or IA rep registration requirements, or an applicable exemption or exclusion;

B. The Internet Communication contains a mechanism, including and without limitation, technical "firewalls" or other implemented policies and procedures, designed reasonably to ensure that prior to any subsequent, direct communication with prospective customers or clients in this state, said broker-dealer, investment adviser, BD agent or IA rep is first registered in this state or qualifies for an exemption or exclusion from such requirement. Nothing in this paragraph shall be construed to relieve a state registered broker-dealer, investment adviser, BD agent or IA rep from any applicable securities registration requirement in this state;

C. The Internet Communication does not involve either effecting or attempting to effect transactions in securities, or the rendering of personalized investment advice for compensation, as may be, in this state over the Internet, but is limited to the dissemination of general information on products and services; and

D. In the case of a BD agent or IA rep:

(1)the affiliation with the broker-dealer or investment adviser of the BD agent or IA rep is prominently disclosed within the Internet Communication;

(2)the broker-dealer or investment adviser with whom the BD agent or IA rep is associated retains responsibility for reviewing and approving the content of any Internet Communication by a BD agent or IA rep;

(3)the broker-dealer or investment adviser with whom the BD agent or IA rep is associated first authorizes the distribution of information on the particular products and services through the Internet

Communication; and

(4)in disseminating information through the Internet Communication, the BD agent or IA rep acts within the scope of the authority granted by the broker-dealer or investment adviser;

2.The position expressed in this Interpretive Order extends to state broker-dealer, investment adviser, BD agent and IA rep registration requirements only, and does not excuse compliance with applicable securities registration, antifraud or related provisions;

3.Nothing in this Order shall be construed to affect the activities of any broker-dealer, investment adviser, BD agent and IA rep engaged in business in this state that is not subject to the jurisdiction of the Administrator as a result of the National Securities Markets Improvements Act of 1996, as amended; and

4.This Order shall remain in effect unless and until subsequently amended or rescinded.

So ordered at (city, state) this _____ day of _____, 1997

_____

(name)

(title)

EXHIBIT C

Farson, Cheryl

From: Duane Thompson [duaneicfp@worldnet.att.net]
Sent: Monday, May 24, 1999 9:56 AM
To: Cheryl Farson
Subject: SEC Custody Letter

SECcustodylet90520.doc

Cheryl,

Thanks very much for inquiring about this issue. Attached is a letter sent last week to the SEC which provides more detail on the constructive custody issue.

Duane Thompson

By Electronic and Regular Mail

May 20, 1999

Mr. Robert Plaze
Associate Director
Division of Investment Management
Stop 5-6
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: Custody Rule

Dear Bob:

The Institute of Certified Financial Planners[1] (the "Institute" or "ICFP"), as you know, in several meetings with the Division over the past year has expressed concern with the broad application of Rule 206(4)-2 (the "Custody Rule") to investment advisers who forward, on behalf of their clients, third-party checks and stock certificates to a custodian. This activity has been called "constructive" or "inadvertent custody" and subjects the adviser to the full requirements of the Custody Rule. The same federal custody requirements are generally mirrored in state investment adviser rules. It is our understanding that the Division's investment adviser task force has begun a top-to-bottom review of the rules promulgated under the Investment Advisers Act of 1940. We ask that, with respect to the constructive custody issue, that your task force consider meaningful reform of the Custody Rule to resolve this problem.

The Institute asks that the task force review the underlying purpose for the Custody Rule in connection with advisers who forward client funds or securities. Federal and state securities regulators traditionally have viewed firm custody of client funds as the greatest potential threat to investor protection. Our interpretation of what we would call 'traditional

[1] The Institute of Certified Financial Planners is a Denver-based professional organization representing more than 15,000 CFP practitioners nationwide. The ICFP also serves as a resource to federal and state regulators on issues related to financial planning.

custody' is when a client gives the adviser written permission to hold client funds or securities in safekeeping, so as to ensure the integrity of the account, and to periodically report to the client about any activity in the account. The Institute believes that this was the specific activity the Commission intended for the Custody Rule to cover when the original rule became effective on April 2, 1962. The adopting release, IA

Release No. 123, was notably silent on situations where the adviser acts as a forwarding agent on behalf of the custodian. The rule, according to the release, was "designed to implement the provisions by requiring an investment adviser who has custody of funds or securities of any client to *maintain* them [emphasis added] in such a way that they will be insulated from and not be jeopardized by financial reverses, including insolvency, of the investment adviser." The Release went on to prescribe the procedures to be taken by an adviser who has custody in maintaining client funds or securities.

These requirements follow a fact pattern of holding client funds in a permanent manner:

- the securities must be segregated and marked as such;
- the funds must be deposited in separate bank accounts with separate records of withdrawals and deposits;
- the adviser must notify the client of the system used in securing the funds;
- the adviser must provide quarterly reporting of each account; and
- an independent accountant must conduct a surprise audit at least once a year.

None of these requirements fit the activity of forwarding client funds or securities, yet the same requirements apply to the temporary holding of such assets.

Over time, the original intent of the Rule has been interpreted to apply to situations that were never addressed or contemplated by the adopting Release. We believe it is time that the SEC revisit the intent and scope of the custody rule.[2] The federal standard[3] is so broadly defined that it creates unreasonable compliance burdens in situations where the adviser

---

[2] The ICFP provided similar comment to the North American Securities Administrators Association ("NASAA") in connection with a proposed definition for "constructive custody" in its model rules. In a letter of response to the ICFP comment letter (attached), NASAA indicated that it would prefer to see guidance on this issue provided by the SEC for purposes of uniform application of the custody rule to such situations.

[3] Custody under the federal rule is defined as "any investment adviser who has custody or possession of any funds or securities in which any client has any beneficial interest."

is simply acting on the request of the client by forwarding a check or security to a third-party custodian. The Commission ostensibly broadened the rule's coverage of advisory activities in IA Release No. 1000 (December 5, 1985) by including within the definition of custody an adviser that "directly or indirectly holds client funds or securities, has any authority to obtain possession of them, or has the ability to appropriate them."

We believe the Commission's earlier expansion of the Custody Rule, and the recently adopted NASAA interpretation of "constructive custody"[4] are steps backward in responding to prevailing practices in the financial services industry. Ironically, and this is reflected in no-action request letters to the Commission, so-called "constructive custody" is in fact typically initiated by the clients, not the adviser or financial planner. Some clients, particularly the elderly, prefer having the adviser forward the check to ensure that it is deposited in the correct account. In these situations, regulators are ignoring the marketplace and concerns of the investors with whom they are charged to protect. In this situation, the zealous interpretations of "constructive" or "inadvertent custody" will only impair the adviser's ability to carry out what the client typically views as a reasonable, routine and expected adjunct to advisory services.

Both the federal and NASAA model rule apply to two materially different kinds of custody activities, assuming the forwarding of a third-party check or security can reasonably be viewed as custody. To the extent that the custody rule requirements should apply to an adviser who simply agrees, at the intermittent request of clients, to forward a check to a third-part custodian, the rule amounts to a costly compliance burden for such *de minimis,* custody-like activities. The only limited relief from the custody requirements granted to an investment adviser is when the adviser acts in the capacity of a registered representative, and where its broker-dealer generally would be subject to Rule 15c3-1 of the Securities and Exchange Act of 1934.

It is true that if a dishonest investment adviser is given a check or security, it is physically possible to forge the client's signature and illegally cash the check. It is also true in theory that even stiffer penalties could be designed and meted out to discourage such actions. On the other hand, where there is no actual evidence that more extreme measures are needed, then the agency responsible for imposing such penalties should attempt to match the penalty to the 'crime.' Are advisers <u>systemically</u> engaging in such *de minimis* custody activities and injuring clients? Have recent SEC enforcement sweeps determined the amount of investor losses attributable to

---

[4] Rule 102(e)(1)-1(a)(7) of NASAA's model rules states that for purposes of the custody rule, "a person will be deemed to have custody if said person directly or indirectly holds client funds or securities, has any authority to obtain possession of them, or has the ability to appropriate them."

this activity, especially in comparison to cases of actual abuse of traditional custody? When, in fact, both the investor and adviser typically view this activity as a customer service, then it is time for regulators on both federal and state levels to review the original premise for a penalty or regulatory requirement that in this instance clearly does not fit the advisory activity.

Further, it is clear that in the event of forgery or theft, in most cases the injured client has resort to a number of different means of redress. First, in the case of checks drawn to the client's custodian banker or broker, the SEC as early as 1983 deemed such checks would not be custody or possession of securities of funds.[5] And in an April 2, 1991, no-action letter to Hayes Financial Services, SEC staff further commented on the responsibility of the bank where the checking account is maintained. In the case of a check drawn to a third party, the adviser "does not have custody or possession of client funds because the check is not considered 'funds' for purposes of the custody rule," according to the Hayes no-action letter. "That check merely represents the client's promise to pay. Consequently, if a bank pays on a stolen check with a forged endorsement, the drawer (here, the client) is not liable to the payee. Therefore, unlike the potential loss associated with stolen securities, the client does not bear the risk of loss associated with a stolen check."

With respect to securities, or stock certificates, both SEC and NASAA custody rules provide for a safe harbor under Section 15 of the 1934 Act, as referenced earlier. The Institute urges the Commission to take the lead in helping to reform a rule not originally intended to apply to the simple process of forwarding checks or securities. In this connection, the ICFP asks the Commission to consider a safe harbor for investment advisers from the Custody Rule by adapting Rule 240.15c3-3(b)(2) of the 1934 Act under the rules of the Investment Advisers Act of 1940 so that a similar transit rule would be available to investment advisers. The adapted rule could state to the effect "that an investment adviser shall not be deemed to be in violation of the provisions of Rule 206(4)-21 with respect to physical possession or control of customers' third-party checks or securities if, solely as the result of normal business operations, temporary lags occur between the time when a security is placed in the possession of the adviser by the client, and provided that the investment adviser takes timely steps in good faith to forward the check or security to the third-party custodian, which may be no later than the end of the next business day."

Current recordkeeping requirements, e.g., maintaining photocopies copies of checks and securities that were forwarded, would allow securities examiners to monitor such activity. The Commission may also consider prohibitions

[5] SEC no-action letter to Lawwill Sena & Weller, Inc., April 10, 1983.

against the use of a transit rule in the event an investment adviser representative or firm did not have an appropriate disciplinary record.

The task force also should consider why other, non-securities regulators do not treat client assets in the same manner. For example, it is a common practice for CPAs when preparing tax returns, especially on behalf of elderly clients, to mail the client's tax return and check to the Internal Revenue Service. (In fact, many financial planners also provide tax preparation services, except that forwarding the client's tax return and check might subject them to the Custody Rule if they are registered investment advisers.) Do state accountancy boards deem CPAs to have control of client funds in these situations? Wouldn't the CPA technically have possession of the funds and thereby subject the accounting client to the same kind of risk as an investment advisory client? Does the Federal Aviation Administration or Federal Trade Commission deem UPS drivers or Federal Express pilots to have custody of client checks on their daily routes? (Postal and commercial mail carriers typically warn customers not to enclose cash in their correspondence, of course, but have no special restrictions on checks or securities of which we're aware.) If these examples seem absurd, then we hope that the point is well taken with respect to the observation that almost anyone can be deemed to have custody in the course of a business day if the definition that affects the regulated community is overly broad in its application.

The ICFP recommends that, if the task force has concerns with promulgating a transit rule for investment advisers, that it first determine empirically whether there is truly a systemic problem with respect to constructive, or *de minimis* custody. If the task force cannot find any broad pattern of so-called custodial abuse and investor losses, then we strongly recommend that consideration be given to amending the definition of custody so that it excludes advisers who use a 24-hour transit rule.

* * * * * *

The ICFP would be pleased to discuss the foregoing comments in greater detail with the task force, and to respond to any additional requests for information. Please feel free to contact the undersigned directly at 1.800.322.4237, ext. 129.

Sincerely,

Duane R. Thompson
Director of Government Relations

EXHIBIT D

ELIOT SPITZER
Attorney General

STATE OF NEW YORK
OFFICE OF THE ATTORNEY GENERAL

(212) 416-8208

DIETRICH L. SNELL
Deputy Attorney General
Division of Public Advocacy

ERIC R. DINALLO
Assistant Attorney General In Charge
Investor Protection and Securities Bureau

April 7, 1999

Duane R. Thompson
Director of Government Relations
Institute of Certified Financial Planners
3801 E. Florida Avenue, Suite 708
Denver, CO 80210-2544

Re: NASAA Investment Adviser ("IA")
Net Worth/Bonding Proposed Rule

Dear Mr. Thompson:

The Net Worth/Bonding Rule Project Group ("Project Group") formed by the North American Securities Administrators Association ("NASAA") thanks you for your comment letter dated March 18, 1999 regarding the proposed revisions to Investment Adviser Rules 102(e)(1)-1, 202(d)-1 and 202(e)-1 which the Project Group is recommending to the NASAA membership for adoption. The project Group has considered and discussed your comments, and appreciates the time and thought put into them. We write now to respond to your requests that we consider additional amendments.

You have suggested that NASAA revisit the intent and scope of the custody rule and in fact, change, it. The issue of the definition of "custody" is a difficult one. As your letter states, the changes to the model rule which are recommended by the Project Group mirror the position taken by the U.S. Securities and Exchange Commission ("SEC"). This was done after extensive thought and discussion by the Project Group. Many states have either formally or informally followed the SEC's position on custody, and the particular change/addition to the rule will generally not represent a change in policy for them.

Regarding your custody example, we believe that currently an investment adviser who receives client funds, which are not endorsed in any way to the investment adviser and that the investment adviser cannot cash or without doing some illegal act and which are immediately

forwarded to the legitimate third party to whom they are intended to go, would not be deemed to have custody. Therefore, the issue simply becomes whether or not "immediately " should be changed to 24 hours.

The SEC's custody position and rules have been in effect for years and we do not know of any situations where "zealous interpretations" of custody has caused investment advisers problems. The custody position and associated rules do not prohibit any investment adviser from having custody; they merely impose certain restrictions and requirements on investment advisers who choose to conduct business in a manner that gives them custody. Further, the SEC no action letters cited in your letter dispel the fear that the NASAA rule would impose the custody net worth requirements upon IAs who forward checks for customers. We have added a drafting note to the proposal to ensure this result.

At this time, the Project Group is unwilling to advocate changes in the custody definition which are not accepted by the SEC. The issue of uniformity between the requirements for SEC registered investment advisers and state regulated investment advisers is a priority. Consistency of rules will allow a smooth business transition from registration or licensure with the states to registration with the SEC.

Regarding the issue of discretion, your comments indicate that an investment adviser with discretion cannot injure an investor and that the only financial incentives to harm an investor through the exercise of discretion is by churning an account (which your letter indicates is a legacy of broker-dealer oversight) or if an investment adviser holds significant interest in a thinly held security (that potentially could be bolstered by client trading activity in the stock).

The net worth rule requiring a $10,000 minimum net worth for investment advisers who exercise discretion is not new. The only addition the Project Group has suggested is that a deficiency in net worth may be met by the posting of a bond, which change you endorsed in your letter.

The Project Group has considered the various circumstances where an IA may exercise discretion and has determined that, as a general matter, discretionary authority continues to warrant separate regulatory attention. We believe, further, that consideration of the drafting of a safe harbor of excluded activities from the definition of discretion raises issues that are quite distinct from the issues of net worth/bonding which are central to the rule. Nevertheless, we believe that the evolution of advisory relationships warrants careful study of whether certain relationships and circumstances might appropriately be excluded from the concept of an IA exercising discretion. Thus we will recommend that the NASAA Board authorize us to study both the scope and appropriate exclusions from the definition of "disclosure."

To: Duane R. Thompson April 7, 1999
Re: NASAA Investment Adviser ("IA") Net Worth/Bonding Proposed Rules -3-

The Project Group thanks you for your valued input and interest, and is confident that NASAA will continue to work with ICFP on both of the issues you have raised. However, we do not feel that changes to our proposals are warranted at this time.

Very truly yours,

/s/

WILLIAM H. MOHR
Assistant Attorney General
Deputy Bureau Chief

WHM:vl

EXHIBIT E

ICAA FAX

Date	May 25, 1999	Number of pages including cover sheet	10

TO: Sharleen Day	
Arizona Securities Division	
Phone	602-542-4242
Fax Phone	602-594-7470
CC:	

FROM:	
Karen L. Barr, General Counsel	
Investment Counsel Association of America, Inc.	
1050 17th Street NW, Suite 725	
Washington, DC 20036-5503	
Phone	(202) 293-ICAA
Fax Phone	(202) 293-4223

REMARKS:

☐ Urgent ☒ For your review ☐ Reply ASAP ☐ Please comment

Ms. Day: per your request, attached are the two documents cited in our letter of May 19, 1999 for which we do not have Federal Register cites. If you would like any additional information, please do not hesitate to call me. –Karen Barr.

Attached by SEC Staff

MEMORANDUM

May 16, 1996

To: Senate Securities Committee Staff

From: Division of Investment Management

Subject: Investment Advisers Integrity Act

In response to your request for technical assistance, the Division of Investment Management provides the following initial comments on Title I of the Staff Draft. The Commission itself has not reviewed these comments and reserves the ability to comment further.

Allocation of Regulatory Responsibilities for Investment Advisers

(b) Preemption

The Section would also add a new Section 203A(b), which preempts state investment adviser laws with respect to investment advisers registered with the Commission. The language of the bill "no law . . . of any State requiring the registration, licensing or qualification as an investment adviser..." is designed to preempt the entire body of state investment adviser laws, while preserving other state laws to which advisers are subject (*e.g.*, common law fiduciary duties, partnership law, trust law, commercial codes). The drafting technique used to accomplish this result was to describe what state adviser laws do (require, registration, licensing or qualifications as an investment adviser) and to provide that these laws do not apply to advisers registered with the Commission. State books and records, bonding and net capital, disclosure and other types of requirements would all be preempted. Only those portions of a state investment adviser law explicitly saved (filing and fee payments) would remain. We suggest, therefore, that the language in section 203A(b)(1) "or other requirement imposed by" is superfluous (page 4, lines 20-21) and should be deleted.

In light of the drafting technique used in the Draft bill and the breadth of regulatory activities that would be preempted, we suggest addition of language that would preserve state anti-fraud jurisdiction with respect to investment advisers registered with the Commission. The Division believes that the states should retain anti-fraud authority.

> "Nothing in this Section shall prohibit the securities commission (or any agency or office performing like functions) of any State from investigating and bringing enforcement actions with respect to fraud or deceit against an investment adviser or a person associated with an investment adviser."

Similar language is used in H.R. 3005 to preserve state anti-fraud authority where the states would otherwise be preempted. Limiting the authority to bringing enforcement actions precludes a state securities commission from re-regulating advisers by issuing anti-fraud rules.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
INVESTMENT MANAGEMENT

March 10, 1998

The Honorable Ed Perlmutter
State Senator
370 17th Street, Suite 2600
Denver, Colorado 80202

Re: Technical Comments on House Bill 98-1244:
Investment Adviser Regulation

Dear Senator Perlmutter:

This is in response to your letter dated March 4, 1998, in which you requested technical comments on Colorado House Bill 98-1244, concerning regulation under the Colorado Securities Act of persons offering investment advisory services. The following comments represent the views of the staff of the Securities and Exchange Commission's Division of Investment Management and do not necessarily represent the views of the Commission itself or any of the Commission's other divisions. Our comments primarily will be directed to any conflicts between the proposed Colorado law and the preemption provisions of the federal Investment Advisers Act of 1940, as amended by the National Securities Markets Improvement Act of 1996.

Overall, the Division welcomes Colorado's consideration of this important legislation, which would establish a system of regulating investment advisers in Colorado similar to that found in 46 other states and the District of Columbia. Among other things, enactment of this legislation would assist the SEC in focusing its resources on larger, national advisers, an outcome that is consistent with Congress' intent in passing the Improvement Act. The commitment by Colorado of additional resources toward protecting clients of smaller investment advisers in Colorado will, as Congress envisioned, improve the level of investor protection that can be provided to citizens of Colorado. We have worked constructively with the Colorado Division of Securities, and its Commissioner, Phil Feigin, on many occasions, and we look forward to doing so again to assist in a smooth transition after the legislation has been passed.

Background

Until Congress passed the Improvement Act at the end of 1996, the SEC and state securities administrators shared overlapping jurisdiction over investment advisers. The industry was experiencing tremendous growth and neither the resources of the SEC nor those of the states could keep up with that growth. The examination cycle of the SEC for small advisers had lengthened to a disturbing 40 years, and many states did not have resources or personnel to conduct examinations. On the other hand, as the number of

states that regulated investment advisers grew, many larger advisers that had developed national businesses complained about the costs and inefficiencies of being regulated by multiple regulators.

Congress addressed these problems in the Improvement Act by dividing regulatory responsibility for investment advisers between the SEC and state securities regulators. Congress believed that investor protection would improve if the SEC focused its resources on the larger advisers while the states focused their efforts on the smaller, local advisers. Smaller advisers would benefit by having regulators who were more accessible and could be more responsive to local considerations. Larger advisers would benefit similarly by being subject to a single set of national regulatory requirements. Both would benefit by the elimination of overlapping regulation.[1]

The Improvement Act reallocated regulatory responsibility by (1) prohibiting most advisers with less than $25 million under management from registering with the SEC if they were subject to regulation by a state,[2] and (2) preempting most state regulation of advisers who remained registered with the SEC. However, states were given some residual authority over SEC registered advisers. States may "license, register, or otherwise qualify" any investment adviser representative of an SEC registered adviser if the representative has a place of business in the state. States also are permitted to require the filing of any documents filed with the SEC solely for notice purposes, and the payment of fees. Finally, states are permitted to investigate and bring enforcement actions with respect to fraud or deceit against investment advisers and persons associated with them. These provisions are codified in Section 203A of the federal Advisers Act.[3]

As we are sure you are aware, it is important for any state legislation to be drafted in a way that is consistent with the regulatory scheme envisioned by the Improvement Act, and to avoid inconsistencies or conflicts with its preemption provisions. With this in mind,

---

[1] Indeed, the new division of responsibilities should allow the SEC to examine all advisers registered with us at least once every five years.

[2] The SEC currently is responsible for regulating all advisers in Colorado because Colorado does not have a state law in place providing for such regulation. If Colorado enacts the pending legislation, the SEC's regulatory responsibilities over smaller advisers in Colorado would end, although the SEC would retain the authority to enforce federal anti-fraud prohibitions against those advisers.

[3] Section 203A(b) provides that "[n]o law of any State or political subdivision thereof requiring the registration, licensing, or qualification as an investment adviser or supervised person of an investment adviser shall apply to any person -- (A) that is registered under section 203 as an investment adviser, or that is a supervised person of such person, except that a State may license, register, or otherwise qualify any investment adviser representative who has a place of business located within that State; or (B) that is not registered under section 203 because that person is excepted from the definition of an investment adviser under section 202(a)(11)."

we reviewed the proposed statutory language of the Colorado House bill, as amended as of February 16, 1998, and have the following comments.

Comments

1. Custody by Representatives. Section 407(5)

Section 407(5) of the House Bill would prohibit an investment adviser representative ("IAR") of an SEC registered adviser (in the terminology of the House bill, a "federal covered adviser")[4] from taking custody or possession of client assets unless he or she complies with various requirements prescribed in the section. To the extent that an IAR of an SEC registered adviser obtains custody of client assets, presumably he would do so on behalf of the firm, which would be legally responsible for their safekeeping.[5] Therefore, the direct effect of the bill would be to regulate the custodial activities of the SEC registered adviser, a function that Congress appears to have intended to be the exclusive responsibility of the SEC. Section 407(5), as it applies to SEC registered advisers, would appear therefore to be preempted by federal law.

More specifically, enactment of Section 407(5) would apparently subject SEC registered advisers in Colorado to two separate custody regulations – one directly by the SEC, and one indirectly by Colorado through its IARs. Because this redundancy appears to be unnecessarily burdensome to these advisers and contrary to one of the stated purposes of the Improvement Act, we urge that Section 407(5) be limited to representatives of state registered advisers.

Subsections 407(5)(b)-(e) of the House Bill, which would impose substantive custody requirements on investment advisers and IARs, follow in large part SEC rule 206(4)-2. That rule is currently under review and may be revised in the future. While Colorado is under no obligation to follow the SEC rule, you may wish to consider whether it might be preferable to give broad authority to the Colorado securities commissioner to prescribe custody rules. Such an approach would provide the commissioner with the flexibility, if he or she believed it appropriate, to revise the rules to conform to an updated SEC rule.

---

[4] Under the House bill, a "federal covered adviser" means an adviser registered with the SEC. In this letter we use the terms interchangeably.

[5] If the IAR assumed custody of clients assets outside of the scope of his employment with the SEC registered investment adviser, he would no longer be acting as an IAR with respect to that client, and would likely have an obligation to register himself as an investment adviser. If this occurred, Colorado would have direct regulatory jurisdiction over his custodial activities (assuming he registered with Colorado rather than the SEC).

2. Mandatory Disclosure. Section 409.5(1)

Section 409.5(1) of the House bill would require an IAR of an SEC registered adviser to furnish a written disclosure statement to each client and prospective client. So long as the representative is acting on behalf of an SEC registered adviser, however, the people to whom the disclosure statement would be furnished are clients and prospective clients of the *adviser*, not the representative. An SEC registered adviser has its own disclosure obligations under federal law, and the direct effect of the bill would be to regulate the disclosure requirements of an SEC registered adviser.

Imposing disclosure requirements on SEC registered advisers appears to go beyond the authority reserved to the states under the Improvement Act. In its release adopting the rules implementing the Improvement Act, the SEC took the position that state disclosure requirements no longer apply to SEC registered advisers.[6] To avoid the likelihood of triggering the preemption provision of the Improvement Act, we urge that this provision be limited to state registered advisers and their representatives.

3. Notice Filing and Fee Requirements. Sections 403 and 404

As discussed briefly above, Colorado is prohibited by the Improvement Act from requiring SEC registered advisers to register with its securities commissioner. Colorado continues to have the authority, however, to require SEC registered advisers to file any document filed with the SEC with it "solely for notice purposes."[7] In addition, states can require the appointment of an agent for service of process and the payment of any fees.

The notice filing and fee payment requirements of the House bill are drafted in a way that strongly suggests the imposition of a Colorado registration requirement for SEC registered advisers. Provisions in the bill refer to notice filings being "effective"[8] and "renewed,"[9] and to the possibility of an SEC registered adviser having its "authority to do business" suspended or revoked.[10] The operation of these provisions and the use of these terms strongly suggest the creation of a registration rather than a mere notice filing obligation. If our analysis is correct, we believe that the provisions would likely be preempted by Section 203A of the federal Advisers Act.

---

[6] Investment Advisers Act Rel. No. 1633 (May 15, 1997), at section II(H)(1).

[7] Improvement Act § 307(a).

[8] Section 403(3)(c) provides that "[a] notice filing shall be effective from its receipt by the securities commissioner until December 31 of each year."

[9] Section 403(3)(c) provides that a notice filing "may be renewed annually" by filing the required documents and paying a fee.

[10] Section 404(3)(b)(I) authorizes the securities commissioner to suspend and revoke an SEC registered adviser's authority to do business in Colorado.

To avoid the creation of a de facto registration requirement for SEC registered advisers, we suggest that the bill be revised to require only the periodic filing of documents and payment of fees, without any reference to them being "effective." In addition, we urge that the penalty provision be redrafted either to require registration (a remedy specifically anticipated by the Improvement Act during the first three years following enactment), or the imposition of penalties similar to those imposed upon other businesses in Colorado that fail to make required filings with a state regulatory agency, such as fines.

4. Definition of "Federal Covered Adviser." Section 201(5.5)

Consistent with the Improvement Act, the House bill would exclude "federal covered advisers" from most of the provisions of the state law. The term "federal covered adviser" is defined in Section 201(5.5)(a) as a person registered or *required to be registered* under the federal Advisers Act. The Advisers Act only prohibits state regulation of advisers that are actually registered with the SEC (or that are excepted from the definition of investment adviser). If an adviser is required to be registered with the SEC, but has not done so, it can be subject to state regulation. Therefore, we suggest that the words "or required to be registered" be deleted.

By excluding them from the definition of "federal covered adviser," Section 201(5.5)(b) requires advisers to local government investment pool trust funds to register with Colorado even if they are "excepted from the definition of 'investment adviser' or exempt from registration under the federal [Advisers Act]." Consistent with the Improvement Act, if such advisers are *exempt* from federal registration, the state may regulate them. If such advisers are *excepted* from the definition of investment adviser, however, the Improvement Act expressly preempts state regulation. Thus, we suggest that the words "excepted from the definition of 'investment adviser'" be deleted from this section.

5. Notification by Adviser Regarding Representatives. Section 406(5)(b)

Section 406(5)(b) would require an SEC registered adviser to notify the Colorado securities commissioner if an IAR ceases to be employed or engaged by the adviser or ceases to act as an IAR. The Improvement Act limits the information required to be supplied to the states by SEC registered advisers to notice filings – copies of filings required to be made with the SEC. Since SEC registered advisers are not required to make these filings with the SEC, Colorado would appear to be preempted from requiring that such filings be made with the state. We suggest that the language covering SEC registered advisers be deleted.

6. Prohibitions Against Fraud

Section 410(l) permits the Colorado securities commissioner to impose certain administrative penalties on advisers that violate rules made by the commissioner to

prohibit unfair and dishonest dealings.[11] We urge that the commissioner's authority be limited to exclude SEC registered advisers. While Colorado retains full and unfettered authority to prohibit fraud and prosecute violations, the Improvement Act restricts the state's ability to develop prophylactic rules that apply to SEC registered advisers. Congress gave that exclusive authority to the SEC to eliminate the system of overlapping regulation that existed before the enactment of the Improvement Act. The House bill's statutory prohibition on fraud in Sections 501(a), (b) and (c) is broad and appears to appropriately encompass the expanse of state prohibitory authority under current federal law. In our view, specific rules adopted by the commissioner could not expand that authority.

Some states have limited the application of state ethics rules by applying them to SEC registered advisers only to the extent that they prohibit fraud. While such limitation clauses succeed in curing conflicts with federal preemption, our experience is that they can confuse advisers who are faced with guessing which of the rules will ultimately be held to apply to them. Some rules, such as prohibitions against stealing client assets, obviously prohibit fraudulent activity, but others may be unclear even to lawyers whether they prohibit fraud or just prohibit activity that can be fraudulent under some circumstances. We believe that the best approach would be to limit any rules to state licensed advisers, and for Colorado simply to rely on Section 501(a), (b) and (c) to prohibit unlawful fraudulent conduct by SEC registered advisers.

The Division welcomes and applauds Colorado's initiative in considering legislation to regulate its investment advisers. In general, such a law would complement the work of the SEC and 46 other states, and appears consistent with Congress' intent when it divided regulatory responsibilities between the states and the SEC in the 1996 Improvement Act. As suggested by the discussion above, however, we are concerned that several of the provisions of the House bill may conflict with the Improvement Act's preemption provisions. If they are enacted, they may lead to needless and expensive litigation over the scope of Colorado's authority to regulate SEC registered advisers. Moreover, until the issues are ultimately resolved by a court, they will continue the burdensome scheme of overlapping and duplicative regulation of the larger advisers Congress sought to eliminate in passing the Improvement Act.

Thank you for providing the staff of the SEC's Division of Investment Management an opportunity to submit comments on this important legislation. We hope that these comments are helpful to you in considering House Bill 98-1244. Please do not

---

[11] We cannot find in the House bill any specific provision by which the securities commissioner is given authority to prescribe such rules and, for purpose of this comment letter, presume that such authority exists under current law so that such a provision is unnecessary. If our assumption is incorrect, consideration should be given of adding such a provision. *See*, Section 206(4) of the federal Advisers Act.

hesitate to call me at (202) 942-0716 if you have any questions or comments about this letter or about any of the staff's proposals for amending the proposed legislation.

Very truly yours,

Robert E. Plaze
Associate Director

cc: Philip A. Feigin
Securities Commissioner

EXHIBIT F

UNETHICAL BUSINESS PRACTICES OF INVESTMENT ADVISERS

Amended April 27, 1997

[¶ 2201]

[INTRODUCTION] A person who is an investment adviser or a federal covered adviser is a fiduciary and has a duty to act primarily for the benefit of its clients. The provisions of this subsection apply to federal covered advisers to the extent that the conduct alleged is fraudulent, deceptive, or as otherwise permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290). While the extent and nature of this duty varies according to the nature of the relationship between an investment adviser and its clients and the circumstances of each case, an investment adviser or a federal covered adviser shall not engage in unethical business practices, including the following:

1. Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser.
2. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within ten (10) business days after the date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.
3. Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account in light of the fact that an adviser in such situations can directly benefit from the number of securities transactions effected in a client's account. The rule appropriately forbids an excessive number of transaction orders to be induced by an adviser for a "customer's account."
4. Placing an order to purchase or sell a security for the account of a client without authority to do so.
5. Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client.
6. Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the investment adviser, or a financial institution engaged in the business of loaning funds.
7. Loaning money to a client unless the investment adviser is a financial institution engaged in the business of loaning funds or the client is an affiliate of the investment adviser.
8. To misrepresent to any advisory client, or prospective advisory client, the qualifications of the investment adviser or any employee of the investment

	¶31,465; Mich. ¶32,585; Miss. ¶34,429F; Mo. ¶35,468; Mont. (Ltr., 1/2/90); Neb. ¶37,420; Nev. ¶38,453; N.H. (Ltr., 4/20/90); N.M. ¶41,530; N.Y. ¶42,521J; N.C. ¶43,437; N.D. (Ltr., 1/2/90); Ohio ¶45,603; Okla. ¶46,500; Ore. (Ltr., 1/2/90); Pa. ¶48,667; P.R. (Ltr., 1/2/90); Tenn. ¶54,426; Tex. ¶55,601; ¶55,602; ¶55,603; ¶55,604; ¶55,605; ¶55,606; ¶55,607; ¶55,608; ¶55,609; Utah ¶57,406A; Vt. (Ltr., 1/23/90); Va. ¶60,435B; S.D. (Ltr., 1/2/90); Wash. ¶61,582B; W.Va. ¶63,476; Wis. ¶64,543; Wyo. ¶66,435.
Real Estate Investment Trusts (CCH NASAA Reports ¶3401)	Ala. ¶7462; Alas. (Ltr., 1/2/90); Ariz. ¶9605; Guam (Ltr., 4/20/90); Ida. (Ltr., 1/2/90); Ind. ¶24,593A; Iowa ¶25,457; Kan. ¶26,407A; Ky. (Ltr., 1/2/90); Mass. ¶31,465; Miss. ¶34,429F; Mo. ¶35,465; Neb. ¶37,419; Nev. ¶38,453; N.H. (Ltr., 4/20/90); N.M. ¶41,532; N.C. ¶43,437; N.D. (Ltr., 1/2/90); Ohio ¶45,702; Okla. ¶46,500, ¶46,636; Ore. (Ltr., 1/2/90); Pa. ¶48,679A; S.D. (Ltr., 1/2/90); Tenn. ¶54,426; Tex. ¶55,741; ¶55,742; ¶55,743; ¶55,744; ¶55,745; ¶55,746; ¶55,747; ¶55,748; Utah ¶57,406A; Vt. (Ltr., 1/23/90); Va. ¶60,435B; Wash. ¶61,582B; W.Va. (Ltr., 4/20/90); Wis. ¶64,543; Wyo. ¶66,435.
Temporary Agent Transfer Program (CCH NASAA Reports ¶401)	See Central Registration Depository chart at ¶6531.
Underwriting Expenses, Underwriter's Warrants, Selling Expenses and Selling Security Holders (CCH NASAA Reports ¶3671)	Ark. 10,437; Ida. ¶21,423A; Iowa ¶25,457; Miss. ¶34,429E; S.C. ¶51,528B; Tex. ¶55,590L; Va. ¶60,435B; Wash. ¶61,582B, ¶61,585G; Wis. ¶64,543.
Unethical Business Practices of Investment Advisers (CCH NASAA Reports ¶2201)	Ala. ¶7436B; Alas. (Ltr., 1/2/90); Ariz. ¶9605; Ark. ¶10,428; Cal. ¶12,219; Conn. ¶14,464, ¶14,465, ¶14,466, ¶14,467; Del. ¶15,549; Fla. ¶17,463; Ga. ¶18,477; Guam (Ltr., 4/20/90); Haw. ¶20,125, ¶20,520; Ida. ¶21,411, ¶21,499; Ind. ¶24,613M; Kan. ¶26,403; Ky. ¶27,404; La. ¶28,142; Me. ¶29,033, ¶29,034, ¶29,035, ¶29,036, ¶29,037; Md. ¶30,121, ¶30,122, ¶30,123, ¶30,124, ¶30,453; Mich. ¶32,102; Minn. ¶33,102, ¶33,103, ¶33,106, ¶33,117, ¶33,118, ¶33,423; Miss. ¶34,517B; Mo. ¶35,102, ¶35,491, ¶35,586; Mont. ¶36,468; Neb. ¶37,423; Nev. (Ltr., 4/20/90); N.H. ¶39,473, ¶39,474, ¶39,475, ¶39,476, ¶39,477, ¶39,479; N.M. ¶41,512, ¶41,513, ¶41,521, ¶41,522; N.C. ¶43,496; N.D. ¶44,462; Okla. ¶46,485; Ore. ¶47,619, ¶47,626; Pa. ¶48,508A, ¶48,522, ¶48,523, ¶48,679; P.R. ¶49,513, ¶49,514, ¶49,516, ¶49,517, ¶49,518, ¶49,520; R.I. ¶50,406C;

	S.C. ¶51,510; S.D. ¶52,754H; Tenn. ¶54,417; Utah (Ltr., 1/29/90); Va. ¶60,458XX; Wash. ¶61,633; W.Va. ¶63,465; Wis. ¶64,585, ¶64,586.
Unequal Voting Rights (formerly, Non-voting Stock) (CCH NASAA Reports ¶2401)	Ala. ¶7453, ¶7462; Alas. ¶8434; Ariz. ¶9605; Ark. ¶10,437; Cal. ¶11,851; Fla. ¶17,476; Ida. ¶21,423A; Ind. ¶24,590; Kan. ¶26,407; Minn. ¶33,501; Miss. ¶34,429F; Mo. ¶35,461; Neb. ¶37,408; Nev. ¶38,453; Ohio ¶45,707; Penn. ¶48,661; Tenn. ¶54,411; Tex. ¶55,590N; Wash. ¶61,582B, ¶61,585G, ¶61,786A, ¶61,810K; Wis. ¶64,543.
Uniform Limited Offering Exemption (CCH NASAA Reports ¶6201)	See Limited Offerings chart at ¶6251.
Unsound Financial Condition (CCH NASAA Reports ¶¶3821--3827)	Ida. ¶21,423A; Iowa ¶25,457; S.C. ¶51,528F; Tex. ¶55,590M; Va. ¶60,435B; Wash. ¶61,582B, ¶61,585G.
Use of Proceeds (CCH NASAA Reports ¶3831--3837)	Ida. ¶21,423A; Iowa ¶25,457; Tex. ¶55,590K; Wash. ¶61,582B, ¶61,585G.
Variable Annuities Companies and Trusts (CCH NASAA Reports ¶3801)	Alas. (Ltr., 1/2/90); Nev. (Ltr., 4/20/90); N.H. (Ltr., 4/20/90); N.D. (Ltr., 1/2/90); S.C. (Ltr., 1/2/90); S.D. (Ltr., 1/2/90); Utah (Ltr., 1/29/90); Vt. (Ltr., 1/23/90); W.Va. (Ltr., 4/20/90).

EXHIBIT G

WAC 460-24A-220. Unethical business practices--Investment advisers and federal covered advisers.

A person who is an investment adviser **or a federal covered adviser** is a fiduciary and has a duty to act primarily for the benefit of its clients. The provisions of this subsection apply to federal covered advisers **to the extent that the conduct alleged is fraudulent, deceptive, or as otherwise permitted by the National Securities Markets Improvement Act of 1996** (Pub. L. No. 104-290). While the extent and nature of this duty varies according to the nature of the relationship between an investment adviser and its clients and the circumstances of each case, an investment adviser or a federal covered adviser shall not engage in unethical business practices, including the following:

(1) Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser.

(2) Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within ten (10) business days after the date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.

(3) Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account in light of the fact that an adviser in such situations can directly benefit from the number of securities transactions effected in a client's account. The rule appropriately forbids an excessive number of transaction orders to be induced by an adviser for a "customer's account."

(4) Placing an order to purchase or sell a security for the account of a client without authority to do so.

(5) Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client.

(6) Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the investment adviser, or a financial institution engaged in the business of loaning funds.

(7) Loaning money to a client unless the investment adviser is a financial institution engaged in the business of loaning funds or the client is an affiliate of the investment adviser.

(8) To misrepresent to any advisory client, or prospective advisory client, the qualifications of the investment adviser or any employees of the investment adviser, or to misrepresent the nature of the advisory services being offered or fees to be charged for such service, or to omit to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading.

(9) Providing a report or recommendation to any advisory client prepared by someone other than the adviser without disclosing that fact. (This prohibition does not apply to a situation where the adviser uses published research reports or statistical analyses to render advice or where an adviser orders such a report in the normal course of providing service.)

(10) Charging a client an unreasonable advisory fee.

(11) Failing to disclose to clients in writing before any advice is rendered any material conflict of interest relating to the adviser or any of its employees which could reasonably be expected to impair the rendering of unbiased and objective advice including:

(a) Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

(b) Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the adviser or its employees.

(12) Guaranteeing a client that a specific result will be achieved (gain or no loss) with advice which will be rendered.

(13) Publishing, circulating or distributing any advertisement which does not comply with Rule 206(4)-1 under the Investment Advisers Act of 1940.

(14) Disclosing the identity, affairs, or investments of any client unless required by law to do so, or unless consented to by the client.

(15) Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment adviser has custody or possession of such securities or funds when the adviser's action is subject to and does not comply with the requirements of Reg. 206(4)-2 under the Investment Advisers Act of 1940.

(16) Entering into, extending or renewing any investment advisory contract unless such contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the advisory fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of contract termination or nonperformance, whether the contract grants discretionary power to the adviser and that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract.

(17) Failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information contrary to the provisions of Section 204A of the Investment Advisers Act of 1940.

(18) Entering into, extending, or renewing any advisory contract contrary to the provisions of section 205 of the Investment Advisers Act of 1940. This provision shall apply to all advisers registered or required to be registered under the Securities Act of Washington, chapter 21.20 RCW, notwithstanding whether such adviser would be exempt from federal registration pursuant to section 203(b) of the Investment Advisers Act of 1940.

(19) To indicate, in an advisory contract, any condition, stipulation, or provisions binding any person to waive compliance with any provision of the Securities Act of Washington, chapter 21.20 RCW, or the Investment Advisers Act of 1940, or any other practice contrary to the provisions of Section 215 of the Investment Advisers Act of 1940.

(20) Engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative in contrary to the provisions of section 206(4) of the Investment Advisers Act of 1940, notwithstanding the fact that such investment adviser is not registered or required to be registered under section 203 of the Investment Advisers Act of 1940.

(21) Engaging in conduct or any act, indirectly or through or by any other person, which would be unlawful for such person to do directly under the provisions of the Securities Act of Washington, chapter 21.20 RCW, or any rule or regulation thereunder.

The conduct set forth above is not inclusive. Engaging in other conduct such as nondisclosure, incomplete disclosure, or deceptive practices shall be deemed an unethical business practice. The federal statutory and regulatory provisions referenced herein shall apply to investment advisers and federal covered advisers, to the extent permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290).

[Added eff. 12-19-85; Amended eff. 2-16-99.]

Order 97010. Dishonest or unethical business practices by investment advisers, investment adviser representatives or federal covered advisers. Pursuant to the South Carolina Uniform Securities Act, South Carolina Code Section 35-1-20, *et seq.*, which grants the Securities Commissioner the authority to issue orders pertaining to broker-dealers and their agents, investment advisers and their representatives, issuers, and certain items with respect to federal covered advisers and federal covered securities, the Commissioner hereby issues the following order prohibiting *dishonest or unethical business practices by investment advisers, investment adviser representatives, and federal covered advisers.*

Each investment adviser and investment adviser representative shall observe high standards of commercial honor and just and equitable principals of trade in the conduct of their business. Acts and practices, including but not limited to the following, are considered contrary to such standards and may constitute grounds for denial, suspension or revocation of registration or such other action authorized by statute.

(1) Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known or acquired by the adviser after reasonable examination of the client's records as may be provided to the adviser.

(2) Placing an order to purchase or sell a security for the account of a client without authority to do so.

(3) Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client.

(4) Exercising any discretionary power in placing an order for the purchase or sale of securities without first obtaining written discretionary authority unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of specified securities shall be executed, or both.

(5) Inducing trading in a client's account that is excessive in size and frequency in view of the financial resources, investment objectives and character of the account.

(6) Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the adviser, or a financial institution engaged in the business of loaning funds or securities.

(7) Loaning money to a client unless the adviser is a financial institution engaged in the business of loaning funds or the client is an affiliate of the adviser.

(8) Misrepresenting to any advisory client, or prospective advisory client, the qualifications of the advisor, its representatives or any employees or misrepresenting the nature of the advisory services being offered or fees to be charged for such services or omitting to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading.

(9) Providing a report or recommendation to any advisor client prepared by someone other than the advisor, without disclosing that fact. (This prohibition does not apply to a situation where the adviser uses published research reports or statistical analyses to render advice or where an adviser orders such a report in the normal course of providing service.)

(10) Charging a client an advisory fee that is unreasonable.

(11) Failure to disclose to a client in writing before entering into or renewing an advisory agreement with that client any material conflict of interest relating to the adviser, its representatives or any of its employees, which could reasonably be expected to impair the rendering of unbiased and objective advice including:

(a) Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

(b) Charging a client an advisory fee for rendering advice without disclosing that a commission for executing securities transactions pursuant to such advice will be received by the adviser, its representatives or its employees or that such advisory fee is being reduced by the amount of the commission earned by the adviser, its representatives or employees for the sale of securities to the client.

(12) Guaranteeing a client that a specific result will be achieved (gain or no loss) as a result of the advice which will be rendered.

(13) Publishing, circulating or distributing any advertisement which does not comply with Rule 206(4)-1 under the Investment Advisers Act of 1940.

(14) Disclosing the identity, affairs, or investments of any client to any third party unless required by law to do so, or unless consented to by the client.

(15) Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the adviser has custody or possession of such securities or funds when the adviser's action is subject to and does not comply with the safekeeping requirements of Rule 206(4)-2 under the Investment Advisers Act of 1940.

(16) Entering into, extending or renewing any investment advisory contract, other than a contract for impersonal advisory services, unless such contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the advisory fee or the formula for computing the fee, the amount or the manner of calculation of the amount of the prepaid fee to be returned in the event of contract termination or non-performance, whether the contract grants discretionary power to the adviser or its representatives and that no assignment of such contract shall be made by the adviser without the consent of the other party to the contract.

(17) Failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information in violation of Section 204A of the Investment Advisers Act of 1940.

(18) Entering into, extending, or renewing any advisory contract which would violate section 205 of the Investment Advisers Act of 1940. This provision shall apply to all advisers registered or required to be registered under the South Carolina Uniform Securities Act, notwithstanding whether such adviser would be exempt from federal registration pursuant to section 203(b) of the Investment Advisers Act of 1940.

(19) Indicating, in an advisory contract, any condition, stipulation, or provisions binding any person to waive compliance with any provision of this act or of the Investment Advisers Act of 1940, or any other practice that would violate section 215 of the Investment Advisers Act of 1940.

(20) Engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative in contravention of section 206(4) of the Investment Advisers Act of 1940, notwithstanding the fact that such investment adviser is not registered or required to be registered under section 203 of the Investment Advisers Act of 1940.

(21) Employing any device, scheme, or artifice to defraud or engaging in any act, practice or course of business which operates or would operate as a fraud or deceit.

(22) Engaging in conduct or any act, indirectly or through or by any other person, which would be unlawful for such person to do directly under the provisions of this act or any rule or regulation thereunder.

The conduct set forth above is not inclusive. Engaging in other conduct such as nondisclosure, incomplete disclosure, or deceptive practices shall be deemed an unethical business practice.

The provisions of this order apply to federal covered advisers to the extent that the conduct alleged is fraudulent, deceptive, or other conduct not excluded from regulation pursuant to the National Securities Markets Improvement Act of 1996 (Pub. L. 104-290). The federal statutory and regulatory provisions referenced in this Order shall apply to investment advisers, investment adviser representatives and federal covered advisers, regardless of whether the federal provision limits its application to advisers subject to federal registration.

Order No. 97010, CHARLES M. CONDON, Securities Commissioner, TRACY A. MEYERS, Assistant Attorney General, Office of the Attorney General, Securities Section, 9-2-97.

➔ ***Proposed for Repeal***

Rule 113-10. Financial statements used in a prospectus. (1) All financial statements submitted with an application to register securities or for inclusion in a Prospectus used in this State shall be certified by an Independent Public Accountant regularly engaged in business as such; provided, however (a) that interim statements prepared since the close of the last fiscal year shall not be required to be certified if prepared on a basis comparable to those certified, and (b) that financial statements approved by the South Carolina Insurance Department or the Securities and Exchange Commission may be accepted by the Securities Commissioner in his discretion.

(2) Where a company has been in business for less than one year and submits one statement only which covers a period of less than one year, such statement shall be certified.

(3) A report signed by the Independent Public Accountant should accompany the statements.

(4) Financial statements filed with an application for registration of securities shall be up-dated when necessary so that the Prospectus as finally approved and in definitive form shall contain statements as of a date not more than 6 months prior to the date of the Prospectus.

(5) A Prospectus relating to securities in registration should be amended or supplemented whenever necessary to reflect any material changes, but in any event at least once in any period of twelve consecutive months, in order to bring financial data up to date. Failure of the registrant to do so shall be considered cause for suspension of registration. It shall be discretionary with the Securities Commissioner whether to require the reprinting of the entire Prospectus.

(6) An Investment Company registered under the Investment Act of 1940 whose prospectus is in compliance with the Securities and Exchange Commission's Rules shall be deemed in compliance with (5).

[Amended and eff. 4-1-76, *South Carolina Department of State, Special Bulletin No. 15,* 4-1-76.]

Sec. 51-4.8 (IA). Dishonest and unethical conduct.

Introduction. A person who is an investment adviser or an investment adviser representative is a fiduciary and has a duty to act primarily for the benefit of its clients. While the extent and nature of this duty varies according to the nature of the relationship between an investment adviser and its clients and the circumstances of each case, an investment adviser or investment adviser representative shall not engage in dishonest or unethical conduct including the following:

A. Recommending to a client, to whom investment supervisory, management or consulting services are provided, the purchase, sale, or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser.

B. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within ten (10) business days after the date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specific security that shall be executed, or both.

C. Inducing trading in a client's account that is excessive in size or frequency in view of the client's financial resources, investment objectives and the character of the account in light of the fact that an adviser in such situations can directly benefit from the number of securities transactions effected in a client's account.

D. Placing an order to purchase or sell a security for the account of a client without authority to do so.

E. Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client.

F. Borrowing money or securities from a client, unless the client is a broker-dealer, an affiliate of the investment adviser, a family member, or a financial institution engaged in the business of loaning funds.

G. Loaning money to a client unless the investment adviser is a financial institution engaged in the business of loaning funds or the client is an affiliate of the investment adviser or a family member.

H. To misrepresent to any advisory client, or prospective advisory client, the qualifications of the investment adviser or any employee of the investment adviser, or to misrepresent the nature of the advisory services being offered or fees to be charged for such service, or to omit to state a material fact necessary to make the statements made regarding qualifications, services, or fees, in light of the circumstances under which they are made, not misleading.

I. Providing a report or recommendation to any advisory client prepared by someone other than the adviser without disclosing that fact. This prohibition does not apply to a situation where the adviser uses published research reports or statistical analyses to render advice or where an adviser orders such a report in the normal course of providing service.

J. Charging a client an advisory fee that is unreasonable in light of the type of services to be provided, the experience of the adviser, the sophistication and bargaining power of the client, and whether the adviser has disclosed that lower fees for comparable services may be available from other sources.

K. Failing to disclose to clients, in writing, before any advice is rendered, any material conflict of interest relating to the adviser or any of its employees which could reasonably be expected to impair the rendering of unbiased and objective advice, including:

1. Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

2. Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the adviser or its employees,

L. Guaranteeing a client that a specific result will be achieved (gain or no loss) with advice to be rendered.

M. Publishing, circulating, or distributing any advertisement which does not comply with Rule 206(4)-1 under the 40 Act.

N. Disclosing the identity, affairs, or investments of any client, unless required by law to do so, or unless consented to by the client.

O. Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment adviser has custody or possession of such securities or funds when the adviser's action is subject to and does not comply with the requirements of Reg. 206(4)-2 under the 40 Act.

P. Entering into, extending, or renewing any investment advisory contract, unless such contract is in writing and discloses, in substance, the information required by Part II of Form ADV. The information required by Part II of Form ADV may be disclosed in a document other than the investment advisory contract, so long as it is disclosed at the time the contract is entered into, extended or renewed.

Q. Failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information in violation of Section 204A of the 40 Act.

R. Entering into, extending, or renewing any investment advisory contract contrary to the provisions of Section 205 of the 40 Act. This provision shall apply to all advisers registered or required to be registered under this Act notwithstanding whether such adviser would be exempt from federal registration pursuant to section 203(b) of the 40 Act.

S. To indicate, in an advisory contract any condition, stipulation, or provision binding any person to waive compliance with any applicable provision of this Act, any rule promulgated thereunder or the 40 Act, or any rule promulgated thereunder, or to engage in or any other practice that would violate Section 215 of the 40 Act.

T. Engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative in contrary to the provisions of Section 206(4) of the 40 Act notwithstanding the fact that such investment adviser is not registered or required to be registered under Section 203 of the 40 Act.

U. Engaging in any conduct or any act, indirectly or through or by any other person, which would be unlawful for such person to do directly under the provisions of this act or any rule thereunder. Such conduct or act includes, but is not limited to, that conduct set forth in this Rule. Engaging in other conduct such as forgery, embezzlement, theft, exploitation, non-disclosure, incomplete disclosure or misstatement of material facts, manipulative or deceptive practices, or aiding or abetting any unethical practice, shall be deemed an unethical business practice and shall be grounds for denial, suspension or revocation of a license. **The federal statutory and regulatory provisions referenced herein shall apply to all investment advisers and investment adviser representatives only to the extent permitted by the National Securities Markets Improvement Act of 1996.**

[Added eff. 12-31-98.]

Sec. 6.10.127. Fraudulent, unethical and deceptive practices prohibited.

(1) A person who is a federal covered adviser or investment adviser is a fiduciary and has a duty to act for the benefit of its clients. The provisions of this rule apply to federal covered advisers to the extent that the conduct alleged is fraudulent, deceptive, or as otherwise permitted by the National Securities Markets Improvement Act of 1996 (PL 104-290). While the extent and nature of this duty varies according to the nature of the relationship between an investment adviser or a federal covered adviser and its clients and the circumstances of each case, an investment adviser or a federal covered adviser shall not engage in unethical business practices, including the following:

(a) recommending to a client the purchase, sale, or exchange of a security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser;

(b) exercising any discretionary power in placing an order for the purchase or sale of a security for a client without first obtaining written discretionary authority from the client within 10 business days after the date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both;

(c) inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objective, and character of the account if the adviser can directly or indirectly benefit from the number of transactions effected in a client's account;

(d) placing an order to purchase or sell a security for the account of a client without authority to do so;

(e) placing an order to purchase or sell a security for the account of a client upon instructions of a third party without first having obtained written third party trading authorization from the client;

(f) borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the investment adviser, or a financial institution engaged in the business of loaning funds or securities;

(g) loaning money to a client unless the investment adviser is a financial institution engaged in the business of loaning funds or the client is an affiliate of the investment adviser;

(h) misrepresenting to a client or prospective client the qualifications of the investment adviser or an employee of the investment adviser; misrepresenting the nature of the advisory services being offered or fees to be charged for the investment advisory service; or omitting to state a material fact necessary to make the statements made regarding qualifications, services, or fees, in light of the circumstances under which they are made, not misleading;

(i) providing a report or recommendation to a client prepared by someone other than the investment adviser without disclosing that fact. This prohibition does not apply to a situation where the investment adviser uses a published research report or statistical analysis to render advice or where an investment adviser orders such a report in the normal course of providing service.

(j) charging a client an advisory fee that is unreasonable in light of the type of services to be provided, the experience and expertise of the investment adviser, the sophistication and bargaining power of the client, and whether the investment adviser has disclosed that a lower fee for comparable services may be available from other sources;

(k) failing to disclose to a client in writing before any advice is rendered a material conflict of interest relating to the investment adviser or any of its employees which could reasonably be expected to impair the rendering of unbiased and objective advice including:

(i) compensation arrangements connected with advisory services to a client which are in addition to compensation from the client for the services; and

(ii) charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to the advice will be received by the investment adviser or its employees;

(l) guaranteering a client that a specific result will be achieved (gain or no loss) with advice which will be rendered;

(m) publishing, circulating or distributing sales material which does not comply with rule 206(4)-1 under the Investment Advisers Act of 1940;

(n) disclosing to a third party the identity, affairs, or investment of a client unless:

(i) required by law to do so; or

(ii) consented to by the client;

(o) taking action, directly or indirectly, with respect to those securities or funds in which a client has a beneficial interest, if the investment adviser has custody or possession of the securities or funds when the investment adviser's action is subject to and does not comply with the requirements of rule 206(4)-2 under the Investment Advisers Act of 1940 or the investment adviser is exempt from these requirements by virtue of Rule 206(4)-2(b);

(p) entering into, extending, or renewing an investment advisory contract, other than a contract for impersonal services, unless the contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the advisory fee, the formula for computing the fee, the amount of or the manner of calculation of the prepaid fee to be returned in the event of contract termination or nonperformance, and whether the contract grants discretionary power to the investment adviser or its representative and that no assignment of such contract shall be made by the adviser without the consent of the other party;

(q) failing to disclose to a client or prospective client each material fact with respect to:

(i) the financial condition of the investment adviser that is reasonably likely to impair the ability of the investment adviser to meet contractual commitments to a client, if the investment adviser has express or implied discretionary authority or custody over the client's funds or securities or requires prepayment of advisory fees of more than $500 from the client, 6 months or more in advance; or

(ii) a legal or disciplinary action that is material to an evaluation of the investment adviser's integrity or ability to meet contractual commitments to a client;

(r) failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material non-public information contrary to the provisions of section 204A of the Investment Advisers Act of 1940;

(s) entering into, extending, or renewing any advisory contract contrary to the provisions of section 205 of the Investment Advisers Act of 1940. This provision is hereby adopted and incorporated herein, and applies to all advisers registered or required to be registered under the Securities Act of Montana, notwithstanding the fact that such investment adviser is not registered or required to be registered under section 203 of the Investment Advisers Act of 1940. Section 205 establishes standards for investment advisory contracts entered into by the adviser and may be obtained from the Commissioner of Securities, P.O. Box 4009, Helena, MT 59604;

(t) to indicate, in an advisory contract, any condition, stipulation, or provisions binding any, person to waive compliance with any provision of this act or of the Investment Advisers Act of 1940, or any other practice contrary to the provisions of section 215 of the Investment Advisers Act of 1940, which is hereby adopted and incorporated herein notwithstanding the fact that such investment adviser is not registered or required to be registered under section 203 of the Investment Advisers Act of 1940. Section 215 of the Investment Advisers Act of 1940 establishes standards for the validity of advisory contracts, and may be obtained from the Commissioner of Securities. P.O. Box 4009, Helena, MT 59604;

(u) engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative, or contrary to the provisions of section 206(4) of the Investment Advisers Act of 1940, which is hereby adopted and incorporated herein. notwithstanding the fact that such investment adviser is not registered or required to be registered under section 203 of the Investment Advisers Act of 1940. Section 206(4) of the Investment Advisers Act of 1940 establishes prohibited practices in the investment advisory business, and may be obtained from the Commissioner of Securities. P.O. Box 4009, Helena, MT 59604;

(v) engaging in conduct or any act, indirectly or through any other person, which would be unlawful for such person to do directly under the provisions of the Securities Act of Montana or any rule or regulation thereunder; and

(w) engaging in other conduct such as non-disclosure, incomplete disclosure, or deceptive practices.

(History: Sec. 30-10-107 MCA; *IMP,* Sec. 30-10-201 MCA; *NEW,* 1989 MAR p. 221, Eff. 1/27/89; *AMD,* Eff. 1-15-99.)

Rule .1801. Dishonest or unethical practices.

(a) An investment adviser or **an investment adviser covered under federal law** is a fiduciary and has a duty to act primarily for the benefit of its clients. **The provisions of this Section apply to investment advisers covered under federal law only to the extent that the conduct alleged is fraudulent or deceptive, or as otherwise permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290).** While the extent and nature of his duty varies according to the nature of the relationship between an investment adviser and its clients and the circumstances of each case, an investment adviser or an investment adviser covered under federal law shall not engage in unethical business practices, including the following:

(1) Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known or acquired by the investment adviser after reasonable examination of such of the client's financial records as may be provided to the investment adviser;

(2) Placing an order to purchase or sell a security for the account of a client without authority to do so;

(3) Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client;

(4) Exercising any discretionary authority in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within 10 business days after the date of the first transaction placed pursuant to oral discretionary authority. Discretionary power does not include a power relating solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both;

(5) Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account;

(6) Borrowing money or securities from a client unless the client is a dealer, an affiliate of the investment adviser, or a financial institution engaged in the business of lending funds or securities;

(7) Lending money to a client unless the investment adviser is a financial institution engaged in the business of lending funds or a dealer, or unless the client is an affiliate of the investment adviser;

(8) Misrepresenting to any advisory client, or prospective advisory client, the qualifications of the investment adviser or any employee of the investment adviser, or misrepresenting the nature of the advisory services being offered or fees to be charged for such service, or omitting to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading;

(9) Providing a report or recommendation to any advisory client prepared by someone other than the adviser without disclosing that fact. (This prohibition does not apply to a situation in which the adviser uses published research reports or statistical analyses to render advice or where an adviser orders such a report in the normal course of providing service.);

(10) Charging a client an advisory fee that is unreasonable in the light of the type of services to be provided, the experience and expertise of the adviser, the sophistication and bargaining power of the client, and whether the adviser has disclosed that lower fees for comparable services may be available from other sources;

(11) Failing to disclose to a client in writing before entering into or renewing an advisory agreement with that client any material conflict of interest relating to the adviser or any of its employees which could reasonably be expected to impair the rendering of unbiased and objective advice including:

(A) Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

(B) Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the adviser or its employees;

(12) Guaranteeing a client that a specific result will be achieved (gain or no loss) as a result of the advice which will be

rendered;

(13) Publishing, circulating or distributing any advertisement which does not comply with Rule 206(4)-1 under the Investment Advisers Act of 1940;

(14) Disclosing the identity, affairs or investments of any client to any third party unless required by law to do so, or unless consented to by the client;

(15) Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment adviser has custody or possession of such securities or funds when the adviser's action is subject to and does not comply with the safekeeping requirements of Rule 206(4)-2 under the Investment Advisers Act of 1940, unless the investment adviser is exempt from such requirements by virtue of Rule 206(4)-2(b);

(16) Entering into, extending or renewing any investment advisory contract, other than a contract for impersonal advisory services, unless such contract is in writing and discloses, in substance: the services to be provided; the term of the contract; the advisory fee or the formula for computing the fee; the amount or the manner of calculation of the amount of the prepaid fee to be returned in the event of contract termination or non-performance; whether the contract grants discretionary authority to the adviser; and that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract;

(17) Failing to disclose to any client or prospective client all material facts with respect to:

(A) A financial condition of the adviser that is reasonably likely to impair the ability of the adviser to meet contractual commitments to clients, if the adviser has discretionary authority (express or implied) or custody over such client's funds or securities, or requires prepayment of advisory fees of more than five hundred dollars ($500.00) from such client, six months or more in advance; or

(B) A legal or disciplinary event that is material to an evaluation of the adviser's integrity or ability to meet contractual commitments to clients; and

(18) Utilizing an agent or subagent who satisfies the definition of an investment adviser representative as set forth in G.S. 78C-2(3), where such agent or subagent is not registered as an investment adviser representative pursuant to G.S. 78C-16;

(19) Failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information contrary to the provisions of Section 204A of the Investment Advisers Act of 1940;

(20) Entering into, extending, or renewing any advisory contract contrary to the provisions of Section 205 of the Investment Advisers Act of 1940;

(21) To indicate, in an advisory contract, any condition, stipulation, or provisions binding any person to waive compliance with any provision of this Act or of the Investment Advisers Act of 1940, or any other practice that would violate Section 215 of the Investment Advisers Act of 1940;

(22) Engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative in contravention of Section 206(4) of the Investment Advisers Act of 1940;

(23) Engaging in conduct or any act, indirectly or through or by any other person, which would be unlawful for such person to do directly under the provisions of this Act or any rule or regulation thereunder.

The conduct set forth in Rule .1801(a) is not exclusive. It also includes employing any device, scheme, or artifice to defraud or engaging in any act, practice or course of business which operates or would operate as a fraud or deceit. The federal statutory and regulatory provisions referenced herein shall apply both to investment advisers and to investment advisers covered under federal law, to the extent permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290).

(b) There shall be a rebuttable presumption that the following legal or disciplinary events involving the adviser or a management person of the adviser (any of the foregoing being referred to hereafter as "person") that were not resolved in the person's favor or subsequently reversed, suspended, or vacated are material within the meaning of Subparagraph (a)(17)(B) of this Rule for a period of 10 years from the time of the event:

(1) A criminal or civil action in a court of competent jurisdiction in which the person:

(A) was convicted, pleaded guilty or nolo contendere ("no contest") to a felony or misdemeanor, or is the named subject of a pending criminal proceeding (any of the foregoing referred to hereafter as "action"), and such action involved: an investment-related business, fraud, false statements, or omissions; wrongful taking of property; or bribery, forgery, counterfeiting, or extortion;

(B) was found to have been involved in a violation of an investment-related statute or regulation; or

(C) was the subject of any order, judgment, or decree permanently or temporarily enjoining the person from, or otherwise limiting the person from, engaging in any investment-related activity;

(2) Administrative proceedings before the Administrator, Securities and Exchange Commission, any other federal regulatory agency or any other state agency (any of the foregoing being referred to hereafter as "agency") in which the person:

(A) was found to have caused an investment-related business to lose its authorization to do business;

(B) was found to have been involved in a violation of an investment-related statute or regulation and was the subject of an order by the agency denying, suspending, or revoking the authorization of the person to act in, or barring or suspending the person's association with, an investment-related business or otherwise significantly limiting the person's investment-related activities; or

(C) was found to have engaged in an act or a course of conduct which resulted in the issuance by the agency of an order to cease and desist the violation of the provisions of any investment-related statute or rule; or

(3) Self-Regulatory Organization (SRO) proceedings in which the person:

(A) was found to have caused an investment-related business to lose its authorization to do business; or

(B) was found to have been involved in a violation of the SRO's rules and was the subject of an order by the SRO barring or suspending the person from membership or from association with other members, or expelling the person from membership; fining the person more than two thousand five hundred dollars ($2,500.00); or otherwise significantly limiting the person's investment-related activities.

(c) The information required to be disclosed by Subparagraph (a)(17) shall be disclosed to clients promptly, and to prospective clients not less than 48 hours prior to entering into any written or oral investment advisory contract, or no later than the time of entering into such contract if the client has the right to terminate the contract without penalty within five business days after entering into the contract.

(d) For purposes of this Rule:

(1) "Management person" means a person with power to exercise, directly or indirectly, a controlling influence over the management or policies of an investment adviser which is not a natural person or to determine the general investment advice given to clients;

(2) "Found" means determined or ascertained by adjudication or consent in a final SRO proceeding, administrative proceeding, or court action;

(3) "Investment-related" means pertaining to securities, commodities, banking, insurance, or real estate [including, but not limited to, acting as or being associated with a dealer, investment company, investment adviser, government securities broker or dealer, municipal securities dealer, bank, savings and loan association, entity or person required to be registered under the Commodity Exchange Act (7 U.S.C. 1 et seq.), or fiduciary];

(4) "Involved" means acting or aiding, abetting, causing, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act; and

(5) "Self-Regulatory Organization" or "SRO" means any national securities or commodities exchange, registered association, or registered clearing agency.

(e) For purposes of calculating the ten-year period during which events are presumed to be material under Paragraph (b), the date of a reportable event shall be the date on which the final order, judgment, or decree was entered, or the date on which any rights of appeal from preliminary orders, judgments, or decrees lapsed.

(f) Compliance with this Rule shall not relieve any investment adviser from the obligations of any other disclosure requirement under the Act, the rules and regulations thereunder, or under any other federal or state law.

History Note: Statutory Authority G.S. 78C-18(b); 78C-30(a); added eff. 2-1-89; amended eff. 9-1-95; temporary amendment eff. 10-1-97; permanent eff. 8-1-98.

R164-6-1g. Dishonest or unethical business practices.

(A) Authority and purpose

(1) The Division enacts this rule under authority granted by Sections 61-1-6 and 61-1-24.

(2) This rule identifies certain acts and practices which the Division deems violative of Subsection 61-1-6(1)(g). The list contained herein should not be considered to be all-inclusive of acts and practices which violate that subsection, but rather is intended to act as a guide to broker-dealers, agents, investment advisers, and federal covered advisers as to the types of conduct which are prohibited.

(3) Conduct which violates Section 61-1-1 may also be considered to violate Subsection 61-1-6(1)(g).

(4) This rule is patterned after well-established standards in the industry which have been adopted by the SEC, the NASD, NASAA, the national securities exchanges and various courts. It represents one of the purposes of the securities laws: to create viable securities markets in which those persons involved are held to a high standard of fairness with respect to their dealings with the public.

(5) The provisions of this rule apply to federal covered advisers to the extent that the conduct alleged is fraudulent or deceptive, or to the extent permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290).

(6) The federal statutory and regulatory provisions referenced in Paragraph (E) shall apply to investment advisers and federal covered advisers, regardless of whether the federal provision limits its application to advisers subject to federal registration.

(B) Definitions

(1) "Division" means the Division of Securities, Utah Department of Commerce.

(2) "Market maker" means a broker-dealer who, with respect to a particular security:

(a) regularly publishes bona fide, competitive bid and ask quotations in a recognized inter-dealer quotation system, or

(b) regularly furnishes bona fide competitive bid and offer quotations to other broker-dealers upon request; and

(c) is ready, willing and able to effect transactions in reasonable quantities at his quoted price with other broker-dealers on a regular basis.

(3) "NASAA" means the North American Securities Administrators Association, Inc.

(4) "NASD" means the National Association of Securities Dealers".

(5) "NASDAQ" means National Association of Securities Dealers Automated Quotation System.

(6) "OTC" means over-the-counter.

(7) "SEC" means the United States Securities and Exchange Commission.

(C) Broker-Dealers

In relation to Broker-Dealers, as used in Subsection 61-1-6(1)(g) "dishonest or unethical practices" shall include:

(1) engaging in a pattern of unreasonable and unjustifiable delays in the delivery of securities purchased by any of its customers or in the payment, upon request, of free credit balances reflecting completed transactions of any of its customers, or both.

(2) inducing trading in a customer's account which is excessive in size or frequency in view of the financial resources and character of the account.

(3) recommending to a customer the purchase, sale or exchange of any security without reasonable grounds to believe that such transaction or recommendation is suitable for the customer based upon reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other relevant information known by the broker-dealer.

(4) executing a transaction on behalf of a customer without prior authorization to do so.

(5) exercising any discretionary power in effecting a transaction for a customer's account without first obtaining written discretionary authority from the customer, unless the discretionary power relates solely to the time or price for the execution of orders, or both.

(6) executing any transaction in a margin account without securing from the customer a properly executed written margin agreement promptly after the initial transaction in the account.

(7) failing to segregate a customer's free securities or securities held in safekeeping.

(8) hypothecating a customer's securities without having a lien thereon unless the broker-dealer secures from the customer a properly executed written consent promptly after the initial transaction, except as permitted by the rules and regulations of the SEC.

(9) entering into a transaction with or for a customer at a price not reasonably related to the current market price of the security or receiving an unreasonable commission or profit.

(10) failing to furnish to a customer purchasing securities in an offering, no later than the date of confirmation of the transaction, either a final prospectus or a preliminary prospectus and an additional document, which together include all information set forth in the final prospectus.

(11) charging fees for services without prior notification to a customer as to the nature and amount of the fees.

(12) charging unreasonable and inequitable fees for services performed, including miscellaneous services such as collection of monies due for principal, dividends or interest, exchange or transfer of securities, appraisals, safekeeping, or custody of securities and other services related to its securities business.

(13) offering to buy from or sell to any person any security at a stated price unless the broker-dealer is prepared to purchase or sell, as the case may be, at the price and under the conditions as are stated at the time of the offer to buy or sell.

(14) representing that a security is being offered to a customer "at the market" or a price relevant to the market price unless the broker-dealer knows or has reasonable grounds to believe that a market for the security exists other than that made, created or controlled by the broker-dealer, or by any person for whom the broker-dealer is acting or with whom the broker-dealer is associated in the distribution, or any person controlled by, controlling or under common control with the broker-dealer.

(15) effecting any transaction in, or inducing the purchase or sale of, any security by means of any manipulative, deceptive or fraudulent device, practice, plan, program, design or contrivance, which may include but not be limited to:

(a) effecting any transaction in a security which involves no change in the beneficial ownership thereof;

(b) entering an order or orders for the purchase or sale of a security with the knowledge that an order or orders of substantially the same size, at substantially the same time and substantially the same price, for the sale of the security, has been or will be entered by or for the same or different parties for the purpose of creating a false or misleading appearance of active trading in the security or a false or misleading appearance with respect to the market for the security; provided, however, nothing in this subparagraph shall prohibit a broker-dealer from entering bona fide agency cross transactions for its customers; or

(c) effecting, alone or with one or more other persons, a series of transactions in any security creating actual or apparent active trading in a security or raising or depressing the price of a security, for the purpose of inducing the purchase or sale of the security by others.

(16) guaranteeing a customer against loss in any securities account of the customer carried by the broker-dealer or in any

securities transaction effected by the broker-dealer with or for the customer.

(17) publishing or circulating, or causing to be published or circulated, any notice, circular, advertisement, newspaper article, investment service, or communication of any kind which:

(a) purports to report any transaction as a purchase or sale of any security unless the broker-dealer believes that the transaction was a bona fide purchase or sale of the security; or

(b) purports to quote the bid price or asked price for any security, unless the broker-dealer believes that the quotation represents a bona fide bid for, or offer of, the security.

(18) using any advertising or sales presentation in such a fashion as to be deceptive or misleading. An example of the prohibited practice would be distribution of any nonfactual data, material or presentation based on conjecture, unfounded or unrealistic claims or assertions in any brochure, flyer, or display by words, pictures, graphs or otherwise designed to supplement, detract from, supersede or defeat the purpose or effect of any prospectus or disclosure.

(19) failing to disclose to a customer that the broker-dealer is controlled by, controlling, affiliated with or under common control with the issuer of any security before entering into any contract with or for a customer for the purchase or sale of the security, and if the disclosure is not made in writing, it shall be supplemented by the giving or sending of written disclosure at or before the completion of the transaction.

(20) failing to make a bona fide public offering of all of the securities allotted to a broker-dealer for distribution, whether acquired as an underwriter, a selling group member, or from a member participating in the distribution as an underwriter or selling group member.

(21) failure or refusal to furnish a customer, upon reasonable request, information to which the customer is entitled, or to respond to a formal written request or complaint.

(22) permitting a person to open an account for another person or transact business in the account unless there is on file written authorization for the action from the person in whose name the account is carried.

(23) permitting a person to open or transact business in a fictitious account.

(24) permitting an agent to open or transact business in an account other than the agent's own account, unless the agent discloses in writing to the broker-dealer or issuer with which the agent associates the reason therefor.

(25) in connection with the solicitation of a sale or purchase of an OTC, non-NASDAQ security, failing to promptly provide the most current prospectus or the most recently filed periodic report filed under Section 13 of the Securities Exchange Act of 1934, when requested to do so by a customer.

(26) marking any order tickets or confirmations as "unsolicited" when in fact the transaction is solicited.

(27) for any month in which activity has occurred in a customer's account, but in no event less than every three months, failing to provide each customer with a statement of account which, with respect to all OTC non-NASDAQ equity securities in the account, contains a value for each security based on the closing market bid on a date certain; provided that, this subsection shall apply only if the firm has been a market maker in the security at any time during the month in which the monthly or quarterly statement is issued.

(28) failing to comply with any applicable provision of the Conduct Rules of the NASD or any applicable fair practice or ethical standard promulgated by the SEC or by a self-regulatory organization to which the broker-dealer is subject and which is approved by the SEC.

(29) any acts or practices enumerated in Section R164-1-3.

(30) failing to comply with a reasonable request from the Division for information or testimony, or an examination request made pursuant to Subsection 61-1-5(5), or a subpoena of the Division.

(D) Agents.

In relation to agents of broker-dealers or agents of issuers, as used in Subsection 61-1-6(1)(g) "dishonest or unethical practices" shall include:

(1) engaging in the practice of lending or borrowing money or securities from a customer, or acting as a custodian for money, securities or an executed stock power of a customer.

(2) effecting securities transactions not recorded on the regular books or records of the broker-dealer which the agent represents, in the case of agents of broker-dealers, unless the transactions are authorized in writing by the broker-dealer prior to execution of the transaction.

(3) establishing or maintaining an account containing fictitious information in order to execute transactions which would otherwise be prohibited.

(4) sharing directly or indirectly in profits or losses in the account of any customer without the prior written authorization of the customer and the broker-dealer which the agent represents.

(5) dividing or otherwise splitting the agent's commissions, profits or other compensation from the purchase or sale of securities with any person not also licensed as an agent for the same broker-dealer, or for a broker-dealer under direct or indirect common control.

(6) for agents who are dually under Rule R164-4-1(D)(4)(b), failing to disclose the dual license to a client.

(7) engaging in conduct specified in subsections (C)(2), (C)(3), (C)(4), (C)(5), (C)(6), (C)(9), (C)(10), (C)(15), (C)(16), (C)(17), (C)(18), (C)(24), (C)(25), (C)(26), (C)(28), (C)(29) or (C)(30) of Rule R164-6-1g.

(E) Investment Advisers and Federal Covered Advisers

In relation to investment advisers, as used in Subsection 61-1-6(1)(g) "dishonest or unethical practices" shall include the following listed practices. In relation to federal covered advisers, as used in subsection 61-1-6(1)(g), "dishonest or unethical practices" shall include the following, but only if such conduct involves fraud or deceit:

(1) Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser.

(2) Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within ten (10) business days after date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.

(3) Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account if that an adviser in such situations can directly benefit from the number of securities transactions effected in a client's account. The rule appropriately forbids an excessive number of transaction orders to be induced by an adviser for a "customer account."

(4) Placing an order to purchase or sell a security for the account of a client without authority to do so.

(5) Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client.

(6) Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the investment adviser, or a financial institution engaged in the business of loaning funds.

(7) Loaning money to a client unless the investment adviser is a financial institution engaged in the business of loaning funds or the client is an affiliate of the investment adviser.

(8) To misrepresent to any advisory client, or prospective advisory client, the qualifications of the investment adviser or any employee of the investment adviser, or to misrepresent the nature of the advisory services being offered or fees to be

charged for such service, or to omit to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading.

(9) Providing a report or recommendation to any advisory client prepared by someone other than the adviser without disclosing that fact. (This prohibition does not apply to a situation where the adviser uses published research reports or statistical analyses to render advice or where an adviser orders such a report in the normal course of providing service.)

(10) Charging a client an unreasonable advisory fee.

(11) Failing to disclose to clients in writing before any advice is rendered any material conflict of interest relating to the adviser or any of its employees which could reasonably be expected to impair the rendering of unbiased and objective advice including:

(a) Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

(b) Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the adviser or its employees.

(12) Guaranteeing a client that a specific result will be achieved (gain or no loss) with advice which will be rendered.

(13) Publishing, circulating or distributing any advertisement which does not comply with Rule 206(4)-1 under the Investment Advisers Act of 1940.

(14) Disclosing the identity, affairs, or investments of any client unless required by law to do so, or unless consented to by the client.

(15) Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment adviser has custody or possession of such securities or funds when the adviser's action is subject to and does not comply with the requirements of Reg. 206(4)-2 under the Investment Advisers Act of 1940.

(16) Entering into, extending or renewing any investment advisory contract unless such contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the advisory fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of contract termination or non-performance, whether the contract grants discretionary power to the adviser and that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract.

(17) Failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information in violation of Section 204A of the Investment Advisers Act of 1940.

(18) Entering into, extending, or renewing any advisory contract which would violate section 205 of the investment Advisers Act of 1940. This provision shall apply to all advisers registered or required to be registered under this Act, notwithstanding whether such adviser would be exempt from federal registration pursuant to section 203(b) of the Investment Advisers Act of 1940.

(19) To indicate, in an advisory contract, any condition, stipulation, or provisions binding any person to waive compliance with any provision of this act or of the Investment Advisers Act of 1940, or any other practice that would violate section 215 of the Investment Advisers Act of 1940.

(20) Engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative in contravention of section 206(4) of the Investment Advisers Act of 1940 notwithstanding the fact that such investment adviser is not registered or required to be registered under section 203 of the Investment Advisers Act of 1940.

(21) Engaging in conduct or any act, indirectly or through or by any other person, which would be unlawful for such person to do directly under the provisions of this act or any rule of regulation thereunder.

[Amended eff. 7-1-90; 6-1-94; 7-14-97; 3-4-98.]

Rule 21 VAC 5-80-200. Dishonest or unethical practices.

A. An investment advisor or federal covered advisor is a fiduciary and has a duty to act primarily for the benefit of its clients. While the extent and nature of this duty varies according to the nature of the relationship between an investment advisor or federal covered advisor and its clients and the circumstances of each case, an investment advisor or federal covered advisor shall not engage in unethical practices, including the following:

1. Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known or acquired by the investment advisor or federal covered advisor after reasonable examination of the client's financial records.

2. Placing an order to purchase or sell a security for the account of a client without written authority to do so.

3. Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party authorization from the client.

4. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within 10 business days after the date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.

5. Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account.

6. Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the investment advisor or federal covered advisor, or a financial institution engaged in the business of loaning funds or securities.

7. Loaning money to a client unless the investment advisor or federal covered advisor is a financial institution engaged in the business of loaning funds or the client is an affiliate of the investment advisor or federal covered advisor.

8. Misrepresenting to any advisory client, or prospective advisory client, the qualifications of the investment advisor or federal covered advisor, or misrepresenting the nature of the advisory services being offered or fees to be charged for such service, or omission to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading.

9. Providing a report or recommendation to any advisory client prepared by someone other than the investment advisor or federal covered advisor without disclosing that fact. This prohibition does not apply to a situation where the advisor uses published research reports or statistical analyses to render advice or where an advisor orders such a report in the normal course of providing service.

10. Charging a client an unreasonable advisory fee in light of the fees charged by other investment advisors or federal covered advisors providing essentially the same services.

11. Failing to disclose to clients in writing before any advice is rendered any material conflict of interest relating to the investment advisor or federal covered advisor or any of his employees which could reasonably be expected to impair the rendering of unbiased and objective advice including:

a. Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

b. Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the advisor or his employees.

12. Guaranteeing a client that a specific result will be achieved as a result of the advice which will be rendered.

13. Publishing, circulating or distributing any advertisement that would not be permitted under Rule 206(4)-1 under the

Investment Advisers Act of 1940 (17 CFR 275.206(4)-1).

14. Disclosing the identity, affairs, or investments of any client to any third party unless required by law or an order of a court or a regulatory agency to do so, or unless consented to by the client.

15. Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment advisor has custody or possession of such securities or funds, when the investment advisor's action is subject to and does not comply with the safekeeping requirements of 21 VAC 5-80-140.

16. Entering into, extending or renewing any investment advisory contract unless such contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the advisory fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of contract termination or nonperformance, whether the contract grants discretionary power to the investment advisor or federal covered advisor and that no assignment of such contract shall be made by the investment advisor or federal covered advisor without the consent of the other party to the contract.

B. An investment advisor representative is a fiduciary and has a duty to act primarily for the benefit of his/her clients. While the extent and nature of this duty varies according to the nature of the relationship between an investment advisor representative and his/her clients and the circumstances of each case, an investment advisor representative shall not engage in unethical practices, including the following:

1. Recommending to a client to whom investment supervisory, management or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known or acquired by the investment advisor representative after reasonable examination of the client's financial records.

2. Placing an order to purchase or sell a security for the account of a client without written authority to do so.

3. Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party authorization from the client.

4. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within 10 business days after the date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.

5. Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account.

6. Borrowing money or securities from a client unless the client is a broker-dealer, an affiliate of the investment advisor representative, or a financial institution engaged in the business of loaning funds or securities.

7. Loaning money to a client unless the investment advisor representative is engaged in the business of loaning funds or the client is an affiliate of the investment advisor representative.

8. Misrepresenting to any advisory client, or prospective advisory client, the qualifications of the investment advisor representative, or misrepresenting the nature of the advisory services being offered or fees to be charged for such service, or omission to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made, not misleading.

9. Providing a report or recommendation to any advisory client prepared by someone other than the investment advisor or federal covered advisor who the investment advisor representative is employed by or associated with without disclosing that fact. This prohibition does not apply to a situation where the investment advisor or federal covered advisor uses published research reports or statistical analyses to render advice or where an investment advisor or federal covered advisor orders such a report in the normal course of providing service.

10. Charging a client an unreasonable advisory fee in light of the fees charged by other investment advisor representatives providing essentially the same services.

Sec. 191--50.104(502). Unethical business practices of investment advisers, and investment adviser representatives, or fraudulent or deceptive conduct by federal covered advisers.

➔ ***Proposed Rule***

50.104(1) A person who is an investment adviser, an investment adviser representative, or a federal covered adviser is a fiduciary and has a duty to act primarily for the benefit of the adviser's clients. The provisions of this rule apply to federal covered advisers to the extent that the conduct alleged is fraudulent, deceptive, or as otherwise permitted by the National Securities Markets Improvement Act of 1996 (NSMIA)(Pub. L. No. 104-290). While the extent and nature of this duty varies according to the nature of each relationship and the circumstances of each case, an investment adviser and an investment adviser representative shall not engage in unethical business practices, and a federal covered adviser shall not engage in fraudulent or deceptive conduct, including the following:

a. Recommending to a client to whom investment supervisory, management, or consulting services are provided the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the client on the basis of information furnished by the client after reasonable inquiry concerning the client's investment objectives, financial situation and needs, and any other information known by the investment adviser.

b. Exercising any discretionary power in placing an order for the purchase or sale of securities for a client without obtaining written discretionary authority from the client within ten business days after the date of the first transaction placed pursuant to oral discretionary authority, unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.

c. Inducing trading in a client's account that is excessive in size or frequency in view of the financial resources, investment objectives and character of the account if the adviser in such situations can directly benefit from the number of securities transactions effected in a client's account. The rule appropriately forbids an excessive number of transaction orders to be induced by an adviser for a "customer's account."

d. Placing an order to purchase or sell a security for the account of a client without authority to do so.

e. Placing an order to purchase or sell a security for the account of a client upon instruction of a third party without first having obtained a written third-party trading authorization from the client.

f. Borrowing money or securities from a client unless the client is a member of the investment adviser's or investment adviser representative's immediate family.

g. Loaning money to a client unless the client is a member of the investment adviser's or investment adviser representative's family.

h. Misrepresenting to any advisory client, or prospective advisory client, the qualifications of the investment adviser, investment adviser representative, or any employee of the investment adviser or investment adviser representative, or misrepresenting the nature of the advisory services being offered or the fees to be charged for such service, or omitting to state a material fact necessary to make the statements made regarding qualifications, services or fees, in light of the circumstances under which they are made.

i. Providing a report or recommendation to any advisory client prepared by someone other than the adviser without disclosing that fact. This prohibition does not apply to a situation where the adviser uses published research reports or statistical analyses to render advice or where an adviser orders such a report in the normal course of providing service.

j. Charging a client an advisory fee that is unreasonable in light of any of the following factors: the type of services to be provided, the experience of the adviser, the sophistication and bargaining power of the client, and whether the adviser has disclosed that lower fees for comparable services may be available from other sources.

k. Failing to disclose to clients in writing before any advice is rendered any material conflict of interest relating to the adviser or any of the adviser's employees which could reasonably be expected to impair the rendering of unbiased and objective advice including:

(1) Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

(2) Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the adviser or the adviser's employees.

l. Guaranteeing a client that a specific result will be achieved (gain or no loss) with advice which will be rendered.

m. Publishing, circulating or distributing any advertisement which does not comply with Rule 206(4)-1 under the Investment Advisers Act of 1940.

n. Disclosing the identity, affairs, or investments of any client unless required by law to do so, or unless consented to by the client.

o. Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment adviser has custody or possession of such securities or funds when the adviser's action is subject to and does not comply with the requirements of Reg. 206(4)-2 under the Investment Advisers Act of 1940.

p. Entering into, extending or renewing any investment advisory contract unless such contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the advisory fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of contract termination or nonperformance, whether the contract grants discretionary power to the adviser, and that no assignment of such contract shall be made by the investment adviser without the consent of the other party to the contract.

q. Failing to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information contrary to the provisions of Section 204A of the Investment Advisers Act of 1940.

r. Entering into, extending, or renewing any advisory contract contrary to the provisions of Section 205 of the Investment Advisers Act of 1940. This provision shall apply to all advisers registered or required to be registered under Iowa Code chapter 502 as amended by 1998 Iowa Acts, chapter 1106, notwithstanding whether such adviser would be exempt from federal registration pursuant to Section 203(b) of the Investment Advisers Act of 1940.

s. Indicating, in an advisory contract, any condition, stipulation, or provisions binding any person to waive compliance with any provision of Iowa Code chapter 502 as amended by 1998 Iowa Acts, chapter 1106, or of the Investment Advisers Act of 1940, or any other practice contrary to the provisions of Section 215 of the Investment Advisers Act of 1940.

t. Engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative contrary to the provisions of Section 206(4) of the Investment Advisers Act of 1940, notwithstanding the fact that such investment adviser is not registered or required to be registered under Section 203 of the Investment Advisers Act of 1940.

u. Engaging in conduct or any act, indirectly or through or by any other person, which would be unlawful for such person to do directly under the provisions of this Act or any rule or regulation thereunder.

50.104(2) The conduct set forth in subrule 50.104(1) is not inclusive. Engaging in other conduct such as nondisclosure, incomplete disclosure, or deceptive practices shall be deemed an unethical business practice. The federal statutory and regulatory provisions referenced herein shall apply to investment advisers, investment adviser representatives, and federal covered advisers to the extent permitted by the National Securities Markets Improvement Act of 1996 (NSMIA)(Pub. L. No. 104-290).

This rule is intended to implement Iowa Code chapter 502 as amended by 1998 Iowa Acts, chapter 1106.

DFI-Sec. 5.06. Prohibited business practices.

Except as otherwise provided in sub. (13), the following are deemed "dishonest or unethical business practices" or "taking unfair advantage of a customer" by an investment adviser or an investment adviser representative under s. 551.34(1)(g), Stats., without limiting those terms to the practices specified in this section:

(1) Exercising any discretionary power in placing an order for the purchase or sale of securities for the account of a customer without first obtaining written discretionary authority from the customer unless the discretionary power relates solely to the price at which, or the time when, an order involving a definite amount of a specified security shall be executed, or both.

(2) Placing an order to purchase or sell a security for the account of a customer upon instructions of a third party without first having obtained written third party trading authorization from the customer;

(3) Inducing trading in a customer's account that is excessive in size or frequency in view of the financial resources and character of the account;

(4) Recommending to a customer the purchase, sale or exchange of any security without reasonable grounds to believe that the recommendation is suitable for the customer on the basis of information furnished by the customer after reasonable inquiry concerning the customer's investment objectives, financial situation and needs, and any other information known by the investment adviser;

(5) Placing an order to purchase or sell a security for the account of a customer without authority to do so;

(6) Borrowing money or securities from, or lending money or securities to, a customer;

(7) Representing itself as a financial or investment planner, consultant, or adviser, when the representation does not accurately describe the nature of the services offered, the qualifications of the person offering the services, and the method of compensation for the services;

(8) Placing an order for the purchase or sale of a security if the security is not registered or the security or transaction is not exempt from registration under ch. 551, Stats.

(9) Placing an order for a customer, or recommending that the customer place an order, to purchase or sell a security through a broker-dealer or agent not licensed under ch. 551, Stats., unless the customer is a person described in s. 551.23(8)(a) to (f), Stats.

(10) Recommending to a customer that the customer engage the services of a broker-dealer, agent or investment adviser not licensed under ch. 551, Stats., unless the customer is a person described in s. 551.23(8)(a) to (f), Stats.

(11) Failing accurately to describe or disclose in advertising or other materials used in connection with the promotion or transaction of investment advisory services in this state, the identity of the investment adviser or the nature of the investment advisory services offered or the employment relationship between the investment adviser and its representatives. For purposes of this subsection, "other materials" include, but are not limited to, business cards, business stationery and display signs.

(12) Taking or having custody of client funds or securities without being in compliance with rule 206(4)-2 of the investment advisers act of 1940 and the net capital requirements in s. DFI-Sec 5.02(2).

(13) The subsections of DFI-Sec. 5.06 shall apply to an investment adviser representative of a **federal covered adviser only to the extent permitted** by section 203(b)(2) of the investment advisers act of 1940, and only to the extent the prohibited conduct involves fraud or deceit.

[Added eff. 1-1-78, amended eff. 1-1-81, 1-1-87, 1-1-90, 1-1-97, emerg. eff. 7-9-98, permanent eff. 1-1-99.]

11. Failing to disclose to clients in writing before any advice is rendered any material conflict of interest relating to the investment advisor representative which could reasonably be expected to impair the rendering of unbiased and objective advice including:

a. Compensation arrangements connected with advisory services to clients which are in addition to compensation from such clients for such services; and

b. Charging a client an advisory fee for rendering advice when a commission for executing securities transactions pursuant to such advice will be received by the investment advisor representative.

12. Guaranteeing a client that a specific result will be achieved as a result of the advice which will be rendered.

13. Publishing, circulating or distributing any advertisement that would not be permitted under Rule 206(4)-1 under the Investment Advisers Act of 1940.

14. Disclosing the identity, affairs, or investments of any client to any third party unless required by law to do so, or unless consented to by the client.

15. Taking any action, directly or indirectly, with respect to those securities or funds in which any client has any beneficial interest, where the investment advisor representative, other than a person associated with a federal covered advisor has custody or possession of such securities or funds, when the investment advisor representative's action is subject to and does not comply with the safekeeping requirements of 21 VAC 5-80-140.

16. Entering into, extending or renewing any investment advisory or federal covered advisory contract unless such contract is in writing and discloses, in substance, the services to be provided, the term of the contract, the advisory fee, the formula for computing the fee, the amount of prepaid fee to be returned in the event of contract termination or nonperformance, whether the contract grants discretionary power to the investment advisor representative and that no assignment of such contract shall be made by the investment advisor representative without the consent of the other party to the contract.

C. The conduct set forth in subsections A and B above is not all inclusive. Engaging in other conduct such as nondisclosure, incomplete disclosure, or deceptive practices may be deemed an unethical business practice except to the extent not permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290).

D. The provisions of this section shall apply to federal covered advisors to the extent that fraud or deceit is involved, or as otherwise permitted by the National Securities Markets Improvement Act of 1996 (Pub. L. No. 104-290).

[Amended eff. 7-1-89; 9-1-97.]